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NO. 22347
NO. 22347-A
NO. 22347-B

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DANIEL B. DURAN, ANTONIO GONZALEZ GUTTIEREZ and JOSE LUIS MARTINEZ CRUZ,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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United States Attorney,
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APPELLEE'S BRIEF

I

STATEMENT OF PLEADING AND FACTS DISCLOSING JURISDICTION

Appellants were indicted by the Federal Grand Jury for the Central Division of the Southern District of California on June 8, 1966 [C. T. 3-9].[1/] The indictment was brought under Title 21 United States Code, Section 174 and charged that the appellants conspired to import narcotics into the United States from Mexico.

1/ "C. T." refers to Clerk's Transcript of Record.

The indictment also charged appellants with the concealment of large quantities of heroin in Los Angeles County.

On July 6, 1966, the case proceeded to trial before Judge Charles H. Carr. On July 8, 1966, the appellants were convicted by a jury on all counts of the indictment [C. T. 66, 67, 68].

On September 26, 1966, appellant Duran was sentenced to the custody of the Attorney General for a period of fifteen (15) years on Counts 1, 2 and 5, the sentence on each count to run concurrently [C. T. 178]. Appellants Cruz and Guttierez were each sentenced to five (5) years on Counts 1 and 5 with the sentence on each count to run concurrently [C. T. 182, 183].

Appellants' Notice of Appeal was timely filed on September 26, 1966 [C. T. 179]. The jurisdiction of the District Court was based upon Title 21, United States Code, Section 174, Title 18, United States Code, Section 3231 and Rule 18 of the Federal Rules of Criminal Procedure. This Court has jurisdiction pursuant to Title 28, United States Code, Sections 1291 and 1294 and Rule 37(a) of the Federal Rules of Criminal Procedure.

II

STATUTE INVOLVED

The indictment was brought under Title 21, United States Code, Section 174 which provides as follows:

> "Whoever fraudulently or knowingly imports or brings any narcotic drug into the United States or

any territory under its control or jurisdiction, contrary to law, or receives, conceals, buys, sells, or in any manner facilitates the transportation, concealment, or sale of any such narcotic drug after being imported or brought in, knowing the same to have been imported or brought into the United States contrary to law, or conspires to commit any such acts in violation of the laws of the United States, shall be imprisoned not less than five or more than twenty years . . .

"Whoever on trial for a violation of this section the defendant is shown to have or to have had possession of the narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains the possession to the satisfaction of the jury."

III

QUESTIONS PRESENTED

A. Have Appellants Voluntarily Waived Their Right Under Rule 41(e) to Move to Suppress Evidence Allegedly the Result Of An Illegal Search and Seizure?

1. Does the failure to object to allegedly illegally seized evidence before or during trial constitute a waiver of appellants' right to suppress such evidence?

2. Where appellants have knowledge of the circumstances surrounding a seizure long prior to trial does the failure to make a pretrial motion to suppress evidence affect a waiver of the right to move to suppress?

B. Were The Searches of the Motel Rooms on May 6th and May 12th Valid?

1. Was the seizure of the heroin on May 6th the result of a private search and as such immune from a Fourth Amendment challenge?

2. Was the search at the Gales Motel based on probable cause?

3. Have appellants waived their right to object to the manner of entry by the police into Room 24 at the Gales Motel?

4. Was the package of heroin found in the Gales Motel lawfully obtained?

C. Was the Evidence Sufficient to Sustain the Verdict of Guilt on Count V?

1. Was the evidence sufficient to establish that appellant Duran was in constructive possession of the heroin charged in Count V?

2. Did the evidence show that appellant Duran had the power to exercise dominion and control over the heroin found at the Gales Motel?

3. Was the evidence sufficient to prove that appellants Cruz and Guttierrez were in joint possession of the heroin found inside their motel room?

D. Was the Evidence Sufficient to Sustain the Finding of Guilt on Count One?

1. Did the trial court properly instruct the jury with regard to the conspiracy charge?

2. Was the evidence sufficient to sustain the conspiracy charge as to appellants Cruz and Guttierrez?

E. Were Appellants Denied the Effective Assistance of Counsel?

1. Were appellants prejudiced by their voluntary choice to be represented by one counsel?

2. Did trial counsel's strategy deprive appellants of the effective assistance of counsel?

F. Did the Trial Court Deprive Appellants of a Fair Trial?

G. Was There Any Multi-Count Prejudice Which Would Require a Reversal of the Entire Judgment of Conviction?

IV

STATEMENT OF FACTS

A. SUMMARY OF THE EVIDENCE

In approximately the third week of April, 1966, appellant Daniel B. Duran met with co-defendant Robert Vasquez and unindicted co-conspirator Alfred Joseph Ales in a restaurant to discuss the importation into the United States of narcotics from Mexico [R. T. 87]. [2/] During the meeting Duran asked Ales to commence working for him in the narcotics traffic. Duran explained his business operations to Ales as follows: Male Mexicans would smuggle heroin in to the United States for Duran and bring it to motels in the El Monte-San Gabriel area [R. T. 89]. After arriving in the United States the Mexicans would telephone Duran to inform him that the narcotics had arrived. Thereafter Duran was to telephone Ales who in turn was to meet the Mexicans, pick up the narcotics and hold it until he received further instructions from Duran [R. T. 88, 89]. Ales was to receive $200.00 for each shipment of narcotics that he picked up for Duran [R. T. 91].

On May 4, 1966, at approximately 6:00 P.M., Ales spoke with Duran at Ales' house [R. T. 92]. Duran then drove Ales to the house of co-defendant Robert Vasquez [R. T. 95]. After arriving at Vasquez' home the three men waited for a telephone call from two

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2/ "R. T." Refers to Reporter's Transcript of the Proceedings.

Mexicans who were due to make delivery of a shipment of narcotics from Mexico [R. T. 97]. The expected call never came through so Duran drove Ales back to Ales' house. Duran stated that he would telephone Ales in one hour. As Ales was getting out of the car Duran handed him a package containing $7,500.00, to pay for the narcotics when it arrived [R. T. 99].

Shortly thereafter Duran telephoned Ales and said that the two Mexican men would call him at 6:00 A. M. [R. T. 100]. At 6:00 A. M. on May 5, 1966, Ales received the call from the Mexicans and was directed to the Nine-0-One Motel in El Monte [R. T. 101]. Ales then picked up Vasquez and both men proceeded to drive to the Motel [R. T. 102].

After arriving at the Motel Vasquez gave the Mexicans the $7,500.00 and Ales received the package containing the heroin [R. T. 103]. Thereafter the two men returned to Vasquez' home where upon examining the package they found 40 condoms containing heroin [R. T. 104]. While Ales and Vasquez were counting the condoms of heroin Duran arrived and instructed Ales to leave 11 condoms with Vasquez and to take 29 condoms with him [R T. 106]. Duran left and thereafter Ales proceeded to rent a room at the Alexandria Motel on Figueroa in Los Angeles. Ales placed the remaining 29 condoms of heroin inside of a brown paper bag and left it under the bed of the motel room [R. T. 107]. Ales then left and returned to his own residence. He only used the motel room as a hiding place for the heroin [R. T. 108].

Thereafter, on the morning of May 6, 1966, the bag

containing the 29 condoms of heroin was found under the bed in the motel room by a member of the motel cleaning staff in the course of his regular daily cleaning chores [C. T. 213]. The package was then taken into the manager's office who in turn notified the police. Officer Panzica arrived at the motel and was shown the paper bag by Mrs. Greves, the Manager. Officer Panzica observed that the bag contained two plastic containers, each one containing numerous condoms with a white powder inside. The officer extracted one condom from the bag, felt it, determined that it contained heroin, then placed the condom back inside the bag. At the direction of the officer the paper bag was then placed back inside the room where it had been found [C. T. 254]. Officer Panzica then telephoned his superior officers and told them that he had found a huge amount of heroin. Shortly thereafter two additional officers of the Los Angeles Police Department arrived at the Alexandria Motel. Officer Evans was advised of Officer Panzica's activities and of the return of the heroin to the motel room. The Manager, Mrs. Greves, then took Officer Evans to the room, opened the door and admitted Officer Evans and his partner. Officer Evans examined the package and determined that it contained narcotics. The package was returned to its original location under the bed and the police officers at the scene placed the room under surveillance [C. T. 213].

At approximately 11:25 A. M., Ales arrived back at the motel to pick up the heroin and was placed under arrest [R. T. 108, C. T. 214]. After his arrest it was determined that Ales had

a record of three prior felony convictions, including two for narcotics violations.

Ales agreed to cooperate with the police and proceeded to implicate Duran and Vasquez. That same evening at approximately 7:30 Ales accompanied Officer Sanchez to his home to await a phone call from Duran [R. T. 208]. However, Ales' phone was out of order so Duran was forced to come by. Ales was sitting in the back room with Officer Sanchez who was dressed in civilian clothes when Duran came walking in [R. T. 209]. Duran said to Ales, "Hi, do you have it?" [R. T. 209]. A relative of Ales then entered the room and said that the place was crawling with cops. Duran then asked if the two men wanted a beer and exited the room. Thereafter Duran was arrested running down the street toward his car [R. T. 296].

On May 11, 1966, acting upon the information supplied by Ales, State Officers proceeded to Robert Vasquez' house to place him under arrest. Vasquez was arrested in the bathroom of his residence flushing powder down the toilet bowl [R. T. 215]. A search of Vasquez' person produced a baseball card on which was written the words: "Gales Motel, 3029 San Gabriel, Room 24." [Ex. 4 c, R. T. 215]. Later that same evening at approximately 12:00 the officers proceeded to the Gales Motel. Officer Sanchez went to stall number 24 where he saw a 1959 blue Mercury bearing California license number JUV 174 [R. T. 219]. Officer Sanchez was able to see into the car and note the vehicle registration which indicated that the car was registered to Juan Gonzales of 3520

Warwick, Los Angeles. Officer Sanchez knew of the address on Warwick as he had previously seen appellant Daniel Duran there on many occasions [R. T. 222].

Thereafter Officer Sanchez proceeded up the stairway of the motel to room 24 accompanied by Officers McCarver and Stevenson [R. T. 222]. Officer Sanchez then stopped outside the door of room 24 and heard what sounded like deep breathing. Officer Sanchez then knocked on the door on two separate occasions, identified himself as a police officer, waited a minute and after receiving no response he entered the room [R. T. 223]. As Officer Sanchez entered he identified himself and showed his identification to appellant Guttierez. Appellants Cruz and Guttierez were searched. A card was taken from the person of appellant Cruz which had Robert Vasquez' telephone number written on it [R. T. 232].

Thereafter the police proceeded to search room 24 for between half an hour to an hour and a half. No narcotics were found in the room at that time but appellants Cruz and Guttierez were arrested on suspicion of narcotics violations in connection with the 29 ounces of heroin found inside the Alexandria Motel on May 6, 1966. About 11 hours later, after appellants Cruz and Guttierez had been taken into custody Mrs. Wise, the motel manager, found a package containing narcotics in a wastebasket lying on its side in Room 24 [R. T. 191]. Mrs. Wise then took the package containing the narcotics downstairs to the motel office and called the police. Thereafter the heroin was turned over to

the police [R. T. 192].

B. THE TRIAL

On Monday, June 20, 1966, appellants Duran, Cruz and Guttierez appeared in District Court before Judge Charles H. Carr for arraignment on the indictment. Attorney David C. Marcus appeared as retained counsel for all three appellants [R. T. 4, Vol. A]. Judge Carr immediately made inquiry as to whether there might be any possible conflict of interest and the following colloquy took place:

> "THE COURT: You represent all three of them?
>
> "MR. MARCUS: Yes, your Honor.
>
> "THE COURT: You have no problems, I take it?
>
> "MR. MARCUS: So far I find no problems.
>
> "THE COURT: Well, now, Counsel, I am not telling you how to run your business, but if there is the slightest hint of conflict you had better be sure of it in advance before we come to trial." [R. T. 4, Vol. A].

Mr. Marcus also indicated that he represented appellants Cruz and Guttierez in the State Court on charges arising out of the same offense [R. T. 4, Vol. A]. Mr. Marcus went on to indicate that he had represented Cruz and Guttierez at the State preliminary hearing and that he was presently moving to dismiss the

State charges. Mr. Marcus also represented to the Court that he had represented co-defendant Robert Vasquez in the State court and that the charges in the State court against Vasquez had been dismissed [R. T. 7, Vol. A].

Mr. Marcus informed the Court that he had a motion to file. The basis of the motion was to suppress the testimony of unindicted co-conspirator Alfred Joseph Ales because Ales' constitutional rights had allegedly been violated [R. T. 11, 12, 16, Vol. A]. Judge Carr advised Mr. Marcus to file his motion prior to trial and that there would be a hearing on the motion the morning of the trial.

On July 1, 1966, Mr. Marcus filed a "Motion to Suppress and Dismiss Indictment." [C. T. 23]. The motion went on to indicate that the appellants "will move said court for its order suppressing and dismissing the indictment in the above-entitled proceedings." As grounds for the motion appellants urged that:

"1. The evidence received by the Grand Jury was insufficient and inadequate in law to support the indictment.

"2. The evidence presented to the Grand Jury in support of the indictment was illegally and unlawfully obtained, in violation of the constitutional rights of each of the named defendants." [C. T. 25].

The affidavit of appellant Daniel B. Duran was the only affidavit filed by appellants in support of their motion. The affidavit states in substance that unindicted co-conspirator Alfred Joseph Ales was unlawfully induced and coerced into testifying

before the Federal Grand Jury without the assistance of counsel and "that by reason of the supervisory authority of the United States District Court over the United States Attorney, the officers, agents and employees of said United States Attorney, the evidence so elicited and unconstitutionally procured from said defendant Ales was inadmissible before the said Federal Grand Jury and is inadmissible before the United States District Court." [C. T. 39]. Finally appellant Duran went on to allege that the "basis for the indictment of the defendants in this matter is solely predicated upon the evidence so elicited from said Ales, and that no other evidence before said Federal Grand Jury is sufficient in itself to support said indictment." [C. T. 39, 40].

On July 5, 1966, appellants appeared before Judge Carr for hearing of their motion to suppress and dismiss the indictment and to commence trial [C. T. 42]. The Court inquired of appellants' counsel as to the grounds for the motion to suppress and dismiss the indictment. Mr. Marcus responded that the motion was predicated on the fact that unindicted co-conspirator Alfred Ales, in the absence of his retained counsel, was taken before the Federal Grand Jury [R. T. 7]. Mr. Marcus went on to argue that Mr. Ales' constitutional rights had been violated and that the appellants should be able to assert the alleged illegality in light of the fact that Ales was part of the conspiracy [R. T. 9]. The motion was denied.

Thereafter, just prior to the selection of the jury, the Court again inquired as to whether there might be any conflict of

interest.

"THE COURT: All right. Are you representing all three of the defendants, Mr. Marcus?

"MR. MARCUS: Yes, Your Honor, I do.

"THE COURT: I take it there is no prospect of any conflict of interest.

"MR. MARCUS: No, Sir." [R. T. 14].

The case then proceeded to trial. The Government called unindicted co-conspirator Alfred Ales as a witness. Appellants' counsel, outside the presence of the jury, requested permission of the Court to interrogate Ales regarding the competency of his testimony [R. T. 84]. Mr. Marcus indicated that he was desirous of interrogating Ales concerning the offers, if any, to induce him to testify on behalf of the Government. The Court first inquired whether Ales had counsel present whereupon Assistant United States Attorney Jo Ann Dunne informed the Court that Ales did not have an attorney present because he had indicated that he did not want one [R. T. 84, 85]. Mr. Marcus concluded by informing the Court that he had with him the transcript of the preliminary hearing where he had represented co-defencant Robert Vasquez [R. T. 85]. The Court denied counsel's request and allowed Ales to testify.

On July 7, 1966, at 9:30 A. M., the third day of trial, appellant Daniel B. Duran failed to appear in Court [R. T. 178]. The Court determined to proceed with the trial in Duran's absence pursuant to Rule 43 of the Federal Rules of Criminal Procedure.

The jury was instructed not to consider Duran's absence in any way in determining his guilt or innocence [R. T. 181], and the trial continued.

During its case-in-chief the Government offered the testimony of Officer Edward Sanchez of the Los Angeles Police Department. During his direct testimony Officer Sanchez testified with regard to the entry and search of Room 24 at the Gales Motel on May 12, 1966 [R. T. 223]. Counsel for the appellants attempted to take Officer Sanchez on voir dire to inquire whether the police had a search or arrest warrant in their possession when they entered Room 24. Thereafter the following colloquy occurred between the Court and counsel:

> "MR. MARCUS: Did you have a search warrant or a warrant of arrest when you entered the premises?
>
> "THE COURT: This comes at a rather late time doesn't it counsel?
>
> "MR. MARCUS: No, Your Honor. Not with respect to this evidence it doesn't.
>
> "THE COURT: Weren't you aware of this prior to now?
>
> "MR. MARCUS: In other proceedings I was aware of this. But it did not, in my opinion, become relevant in this case until this moment." [R. T. 233].

Thereafter counsel objected to any testimony regarding Exhibit 8 (the card found on appellant Cruz bearing Robert Vasquez'

telephone number) on the ground of illegal search and seizure [R. T. 234]. The motion was denied, the Court holding that counsel had waived his opportunity to move for suppression of evidence under Rule 41 of the Federal Rules of Criminal Procedure [R. T. 238]. Further on the Court stated:

> "Now the whole tenor of your motion was what occurred before the Grand Jury, and I find nothing in the affidavit or motion relating to any unlawful arrest procedure." [R. T. 258].

Finally the Court observed that Mr. Marcus "has read from records showing that he is fully familiar with these matters, that he has had ample opportunity and has known all about the situation and circumstances of this arrest long prior to this trial, and that he has not filed a motion in accordance with Rule 41(e)." [R. T. 260].

At the conclusion of the Government's case-in-chief Mrs. Dunne offered Exhibits IB and 2B [R. T. 360, 364]. Mr. Marcus objected to the introduction of I-B (the heroin found at the Alexandria Motel on May 6, 1966) [R. T. 303] on the grounds that:

1.) No conspiracy had been established;

2.) No corpus delicti had been established;

3.) The insufficiency of evidence [R. T. 302].

The motion was denied and Exhibits I-B and 2-B (the heroin found on May 12, 1966, at the Gales Motel) was admitted into evidence [R. T. 307]. Thereafter counsel moved for a judgment of acquittal

on the grounds of:

1.) Insufficiency of the evidence;

2.) That no conspiracy had been established between the defendants;

3.) That no corpus delicti had been established insofar as the three defendants were concerned [R. T. 309]. The motion was denied.

At the conclusion of appellants' case Mr. Marcus again moved for a judgment of acquittal based on the alleged failure of the Government to prove a corpus delicti and a lack of possession as to appellant Duran [R. T. 435]. The motion was denied. After argument by counsel the Court proceeded to instruct the jury on the law. At the conclusion of the Court's instructions no objections were made as to any of the instructions. The Court inquired at that time:

> "THE COURT: All right, gentlemen. Do you feel it is necessary to approach the bench?
>
> "MR. MARCUS: No, Your Honor.
>
> "THE COURT: You have the opportunity if you desire it.
>
> "MR. MARCUS: No, Your Honor." [R. T. 561].

Thereafter, all of the defendants were convicted by the jury on the charges in the indictment.

V

ARGUMENT

A. APPELLANTS HAVE KNOWINGLY AND VOLUNTARILY WAIVED THEIR RIGHT UNDER RULE 41(e) TO MOVE TO SUPPRESS EVIDENCE ALLEGEDLY THE RESULT OF AN ILLEGAL SEARCH AND SEIZURE.

Appellants now claim for the first time that the 29 ounces of heroin found in the Alexandria Motel on May 6, 1966, was the product of an illegal search and seizure. Appellants also allege that the search of the Gales Motel on May 12, 1966, was illegal.

On June 8, 1966, the indictment in the instant case was returned. Trial was set for July 5, 1966. The Court ordered that all motions be filed by June 24, 1966. On July 1, 1966, a "Notice of Motion to Suppress and Dismiss Indictment" was filed supported by an affidavit of appellant Daniel B. Duran. The affidavit at page 14, clearly states that the purpose of the motion was to dismiss the indictment. It was not a motion to suppress evidence alleged to have been illegally seized. The affidavit endeavors to establish the bias and prejudice of a witness, Alfred Joseph Ales; it also alleges that certain of Mr. Ales' constitutional rights under the Fifth and Sixth Amendments to the Constitution had been violated.

On the morning of trial, the defendants made certain oral motions which were denied. They did not make a motion to suppress the evidence [R. T. 4-14, Vol. 1].

The Government offered testimony concerning Exhibit I-B

(the 29 ounces of heroin described in Counts One and Two of the indictment, seized on May 6, 1966, at the Alexandria Motel), and Exhibit II-B, (approximately 20 ounces of heroin described in Count Five of the indictment, seized on May 12, 1966, at the Gales Motel). When the Government offered these two exhibits into evidence there was no objection on the ground of an illegal search and seizure [R. T. 302].

At the conclusion of the Government's case in chief, the defense moved for a judgment of acquittal. The motion for acquittal was not based on the ground of an illegal search and seizure [R. T. 309]. At the conclusion of the entire case, appellants renewed their motion for a judgment of acquittal. The motion for judgment of acquittal was not based on the ground of an illegal search and seizure [R. T. 435].

The only objection to the introduction of evidence on the ground of an illegal search and seizure was made orally during the testimony of the Government's seventh witness, regarding Government's Exhibit No. VIII (a piece of cardboard containing the telephone number of Robert Vasquez which was removed from the person of appellant Cruz following his arrest) [R. T. 234].

Appellants had previously been made aware of Exhibit VIII and the circumstances surrounding its seizure because Sergeant Sanchez of the Los Angeles Police Department had previously testified regarding the Exhibit and the search of the Gales Motel in the state court preliminary hearing on May 23, 1966, when Mr Marcus acted as defense counsel for appellants Cruz and Guttierez

[R. T. 264]. The only explanation offered for the untimely motion by Mr. Marcus was that although the defense was aware of this evidence and the circumstances surrounding its seizure, from the state court proceedings, they did not feel that the issue became relevant in the instant case until that particular moment [R. T. 233].

1. The Failure To Object To Evidence Alleged To Have Been Illegally Seized Before Or During Trial Constitutes A Waiver Of The Right To Suppress Such Evidence.

Rule 41(e), Federal Rules of Criminal Procedure provides that:

> "The motion [to suppress illegally seized evidence] shall be made before trial or hearing unless opportunity therefor did not exist or the defendant was not aware of the grounds for the motion, but the court in its discretion may entertain the motion at the trial or hearing."

It is a well-settled principle that if a defendant was aware of the grounds for a motion to suppress evidence and had ample opportunity to make such motion, but failed to make either a pre-trial motion or to object during the trial, the defendant has waived his right to object to the admissibility of the evidence seized.

This Court has previously held that:

"Failure to make objection to evidence either before or at trial precludes consideration of objections thereto on appeal unless good cause of such failure is shown . . . No good cause is shown here."

Bouchard v. United States, 344 F. 2d 872, 875 (9th Cir. 1965).

In Billeci v. United States, 290 F. 2d 628 (9th Cir. 1961) the defendant failed to move to suppress evidence before or during trial. On appeal defendant contended that the disputed evidence was the fruit of an illegal search and seizure. This Court stated:

"The admitted normal rule is that an appellate court will not consider matters which are alleged as error for the first time on appeal, and this is true of criminal as well as civil cases. However, an exception exists in criminal cases where the alleged error would result in a manifest miscarriage of justice, or would seriously affect the fairness, integrity, or public reputation of judicial proceedings. The appellate tribunal will examine the record sufficiently to determine whether such has occurred." (Id. at 629)

However, even assuming that the disputed evidence was obtained from an illegal search and seizure, the court in Billeci adjudged that the erroneous admission of such evidence did not have a detrimental effect on the trial. Therefore, the court declined to consider the issue on appeal, stating:

"Evidence which is the product of an illegal seizure is not denied admission in a federal criminal proceeding because it is necessarily untrustworthy but rather it is excluded on the grounds of public policy to discourage overzealous law enforcement officers from resorting to police state tactics . . . The admission of such evidence could not affect the 'fairness, integrity, or public reputation' of the proceedings below. Appellant's failure to proceed in accordance with Rule 41(e) prevents this court from now considering this claimed error." (Id. at 629).

Other grounds on which Appellate courts have based their refusal to consider the issue of probable cause for the first time on appeal were set forth in Gendron v. United States, 295 F. 2d 897 (8th Cir. 1961) citing and following Billeci v. United States, supra, where the Eighth Circuit noted:

"The plain error rule should be applied with caution and should be invoked only to avoid a clear miscarriage of justice. To exercise the right freely would undermine the administration of justice and detract from the advantage derived from ordered rules of procedure." (Id. at 892).

Moreover, in Gendron the Eighth Circuit discerned that to consider the matter on appeal for the first time would sometimes

allow the defendant to assert a contention inconsistent with his theory of defense at trial. In Gendron, the defendant was charged and convicted of receiving and concealing stolen government bonds. His defense at trial was his contention that he did not know the bonds were in his automobile where they were seized by government agents. The Eighth Circuit did not see why defendant should be allowed to assert the issue of probable cause on appeal when he unsuccessfully pursued another theory at trial. (Id. at 903).

Accord: Bouchard v. United States, supra;

Barba-Reyes v. United States, 387 F. 2d 91, 93 (9th Cir. 1967);

Williams v. United States, 358 F. 2d 325 (9th Cir. 1966);

United States v. Weldon, 384 F. 2d 772, 775 (2nd Cir. 1967).

Likewise, in the case at bar appellants were charged and convicted of concealing and conspiring to smuggle and conceal heroin. Their defense in the court below was that the heroin found in the two motel rooms did not belong to them and that they did not know that the heroin was even in the rooms.

2. Where Defendants Have Knowledge Of The Circumstances Surrounding A Seizure Long Prior To Trial And Fail To Make A Motion To Suppress Before Trial They Have Waived Their Rights With Respect To The Admissibility Of Such Evidence.

Where the record is clear that the defense has knowledge of a seizure long prior to trial and where counsel has had ample opportunity to exercise the right provided by Rule 41(e) to suppress the fruits of that search the appellants will be deemed to have waived the right to move to suppress the evidence unless such motion is made prior to trial. In Rocchia v. United States, 78 F. 2d 966 (9th Cir. 1935) this Circuit held:

> "It has been uniformly held that a motion to suppress made upon the trial comes too late where the defendant has knowledge of the seizure long prior to the trial and neglects to make such a motion before trial."

See also: Rose v. United States, 149 F. 2d 755, 760 (9th Cir. 1945) (opinion emphasizes that defendant knew of the seizure for seven months prior to trial.); United States v. Fowler, 17 F.R D., 499, 500 (S. D. Calif. 1955) (When defendant moves to suppress at trial . . . "the Court must be satisfied that the accused could not at an earlier stage have had adequate knowledge to make his claim."

In United States v. Shavin, 320 F. 2d 308, 313 (7th Cir. 1963):

"The indictment was returned on March 30, 1961; the trial was commenced on November 20, 1961, and not until the trial had proceeded into the testimony of the fourth witness did the defendant make a motion to suppress the evidence . . . Under the circumstances presented the defendant must have been aware of the grounds for his motion to suppress and had a long period of time prior to the trial to file the motion. The trial court was, therefore, justified in denying the motion to suppress at the time it was presented."

With regard to the issue of appellants' admitted prior knowledge of the facts surrounding the seizure of May 12, 1966, at the Gales Motel the case of United States v. Watts, 319 F. 2d 659 (2nd Cir. 1963) is particularly significant. In the Watts case the defendant filed a motion to suppress evidence prior to trial. Following hearing thereon the Court denied the motion without prejudice. Trial commenced and resulted in a mistrial. A new trial date was set. Defendant filed no motion to suppress evidence prior to the second trial. In defendant's opening statement at the second trial, he mentioned an illegal search and seizure and a motion to suppress evidence. In addition, at the time the Government sought to introduce the evidence at the second trial the defendant objected on the ground of illegal search and seizure. The District Court Judge declined to entertain a motion to suppress

since the defendant had failed to raise the issue in advance of trial and could have done so. The Circuit Court held that the defendant clearly had an awareness of the grounds for the motion and an opportunity to make the motion. Therefore, the District Court did not abuse its discretion in refusing to conduct a hearing at that late date.

In the case at bar the record is clear that appellants had full knowledge of the facts and circumstances surrounding the searches in question. Trial counsel's decision to follow another line of defense other than the one presently being urged before this Court was freely and intelligently taken. Appellants should not now be allowed to challenge searches to which they made no proper objection in the Court below. Without the proper motion having been made the record on this appeal is of course inadequate in that the circumstances of the searches were never fully developed.

B. THE SEARCHES OF THE MOTEL ROOMS ON MAY 6th AND MAY 12th WERE VALID.

It is the Government's contention that appellants have waived any rights to challenge the searches of the motel rooms in question. However, should this Court wish to consider the issue of the legality of the searches for the first time on this appeal the Government's position will be set forth below.

Preliminarily it should be noted that the facts and

circumstances surrounding the search of Alfred Ales' room at the Alexandria Motel on May 6, 1966, were never fully developed in the Court below. The facts relied upon by appellants and the Government before this Court are taken from the affidavits of Los Angeles Police Officers filed in the related prosecution of co-defendant Robert Vasquez. (United States v. Robert Vasquez, No. 36277-CD). The inadequacy of the record on this point should serve to substantiate the Government's position that appellants' failure to move timely to suppress in the District Court and their failure to develop all of the relevant facts surrounding the search should preclude them from now attacking the search.

1. The Seizure Of The Package Found In Ales' Motel Room Was The Result Of A Private Search And As Such Is Immune From A Fourth Amendment Challenge.

Appellants acknowledge the validity of the principle set forth in Burdeau v. McDowell, 256 U.S. 465 (1921), "to the effect that the Fourth Amendment does not apply to searches and seizures conducted by private persons." Appellants, however, seek to distinguish the Burdeau case by alleging that here state officers participated in the search. While the record is not as clear as would be desirable it is readily apparent that in the instant case the Motel Manager, Mrs. Greves, actually turned over the incriminating evidence to the state authorities thus effecting a "fait accompli" requiring no further Government action to procure the evidence. Appellants concede that "In Burdeau

private persons stole incriminating papers and delivered them to federal prosecutors. Thus, in that case federal officers were forced with a fait accompli, no further Government action was necessary to procure the evidence. There was nothing left to seize and no search was necessary." (Appellants' Brief page 39).

The Government would submit that appellants are correct in this regard and that, furthermore, the facts of the instant case are practically indistinguishable from Burdeau. Mrs. Greves actually handed the heroin over to officer Panzica. While the record is not clear as to exactly what Mrs. Greves actually told Officer Panzica when he first arrived at the Alexandria Motel it is submitted that his action was perfectly reasonable and in no way could it be considered an improper police action. In fact, had he failed to look into the suspicious package which Mrs. Greves handed to him he might well have been considered to have been derelict in his duties as an officer. See Frye v. United States, 315 F. 2d 493 (9th Cir. 1960).

It is important to note that this is not a case where a private party "discovers contraband and notifies the . . . agents of that fact, and the agents then secure a warrant on the basis of this information and conduct a search." Corngold v. United States, 367 F. 2d 1, 6 (9th Cir. 1966). It is submitted that the above-quoted dictum from Corngold would appear to pertain to a circumstance where a private party finds obvious contraband and then telephones the authorities indicating to them that he has in his possession the contraband and that there is no danger of destruction

or removal of the contraband. In the case at bar the most that the record shows is that Officer Panzica received a radio call to see a woman at the Alexandria Motel regarding found property [C. T. 253]. The record does not indicate that he ever knew that the property was in fact heroin until he first examined it. Thus, by the time Officer Panzica knew that the package contained heroin he had already seen and touched the narcotics; thus obviating any reason he might have had to obtain a search warrant which would only have enabled him to see what he had already seen.

The Government would submit that Officer Panzica's actions were, taken as a whole, reasonable and proper, If this is so the requirement of obtaining a search warrant vanished when "no further Government action was necessary to procure the evidence." (Appellants' Brief, page 39).

Finally, it is important to distinguish the Corngold case, supra, from the instant one. In Corngold the Customs Agents initiated, directed and participated in the search. Thus Corngold should be limited to its particular factual situation and should have no application to a case such as this one where a conscientious private citizen suspects that he has discovered contraband and a police officer arrives upon the scene merely to corroborate or reject the citizen's suspicions.

2. The Search Of Cruz' and Guttierez' Motel Room On May 12, 1966, Was Lawful As It Was Based On Probable Cause.

At the time that the Los Angeles Police Officers proceeded to the Gales Motel to arrest appellants Cruz and Guttierez they were aware of the following facts and circumstances:

1. Alfred Ales had told the police Officers that appellant Daniel Duran had employed two male Mexicans to smuggle heroin for him from Mexico on a regular basis.

2. Ales told the police that the two Mexicans stayed at Motels in the El Monte and San Gabriel area.

3. Ales also informed the police that Robert Vasquez was employed by Duran to accept delivery and store the heroin for him.

4. Ales told the Officers that on May 5th two male Mexicans had delivered heroin to Vasquez and Ales to store for Duran.

5. On May 11, 1966, at approximately 4:00 P. M., appellants Cruz and Guttierez checked into Room 24 at the Gales Motel.

6. At approximately 6:00 P. M., on May 11, 1966, the officers arrested Robert Vasquez at his residence and found him to be in possession of narcotics and a card bearing the writing -- Room 24, Gales Motel, 3029 So. San Gabriel.

7. When the officers arrived at the Gales Motel they observed a car in the stall reserved for Room 24. The officer

was able to determine that the car was registered to 3520 Warwick Street, Los Angeles, California, an address where officer Sanchez had seen appellant Daniel Duran on several occasions.

The Supreme Court, on numerous occasions, has defined "probable cause". In Brinegar v. United States, 338 U. S. 160, 175 (1949), the Court stated:

> "In dealing with probable cause, however, as the very name implies, we deal with probabilities. These are not technical; they are the factual and practical considerations of every day life on which reasonable and prudent men, not legal technicians, act. The standard of proof is accordingly correlative to what must be proved."

It is the rule that probable cause to arrest may be established solely on information received from a reliable informant. An informant is reliable if the information he supplies is corroborated. Jones v. United States, 326 F. 2d 124 (9th Cir. 1963), Draper v. United States, 358 U. S. 307 (1959). The facts and circumstances listed above which were within the officer's knowledge prior to the arrest clearly indicate that the information supplied by Alfred Ales had been corroborated. It is submitted that the above mentioned information constituted facts and circumstances within the arresting officer's knowledge which were sufficient to warrant a prudent man in believing that appellants had committed and were committing a violation of the state and federal narcotics

laws.

3. Appellants Have Waived Their Right To Object To The Entry Into Room 24 Of The Gales Motel.

Appellants argue that the police officers entry into Room 24 at the Gales Motel on May 12th was unlawful in that there was a failure to comply with Section 844 of the California Penal Code which requires that a police officer, before breaking open a door to effect an arrest, must first demand admittance and explain the purpose for which admittance is desired. The Government would submit that appellants' failure to file a pre-trial motion under Rule 41(e) to suppress precludes them from now raising this issue for the first time on this appeal. The Government's argument with regard to waiver for failure to comply with Rule 41(e) is set forth above and will not be reiterated.

The Court's attention is respectfully directed to the Reporter's Transcript, page 223, for Officer Sanchez' testimony indicating that he did knock on the door of Room 24 on two occasions and identify himself as a police officer. Furthermore, the record is clear that at no time did trial counsel for appellants object to the entry on the basis that there had been a failure to comply with Section 844 of the California Penal Code. When counsel finally did make a belated objection to the introduction of the card seized from appellant Cruz (Exhibit 8) the objection was on the grounds of an illegal search and seizure apparently based on the fact that the officers were not in possession of warrant of

arrest or a search warrant [R. T. 234].

It is submitted that trial counsel's failure to object to the police officers' entry into Room 24 either in a Rule 41(e) motion prior to trial or during the actual trial precludes appellants from raising this issue for the first time on this appeal.

4. The Package Found In The Gales Motel Was Lawfully Obtained.

Appellants complain that the package containing heroin found by Mrs. Wise in their motel room approximately eleven hours after they had been arrested was inadmissible in that the officers opened the package without first obtaining a search warrant. Appellants also contend that Mrs. Wise's conduct "was as much a part of the police action as if she had helped the officers search the room the night before." (Appellants' Brief, page 51). The Government would contend that Mrs. Wise's action in turning over the package to the police was the action of a private citizen whose suspicions had been duly aroused the previous evening by the police arrest of the occupants of Room 24.

The record is clear that Mrs. Wise did not enter the room with any intent to further police activities. She entered the room for the sole purpose of cleaning it so that it would be in order for the next occupants. After finding the package inside the waste-basket Mrs. Wise proceeded to turn it over to the police, apparently assuming that the package had eluded the police search the

evening before. Again, as in the case of the seizure of the package found at the Alexandria Motel, we have a private party discovering a suspicious package and turning it over to the police. Again Burdeau v. McDowell, supra, should be applicable. After Mrs. Wise found the package and turned it over voluntarily to the police "no further Government action was necessary to procure the evidence. There was nothing left to seize and no search was necessary." (Appellants' Brief, page 39).

The Government would also submit that in the case at bar appellants may be deemed to have abandoned the package and are therefore precluded from asserting that the seizure of the package was the result of an unlawful search and seizure. Mrs. Wise testified that she found the package in a wastebasket underneath the writing desk. At the time that the package was found appellants had been forcibly ejected from the Motel room therey effecting an abanonment of any property which they voluntarily choose to leave behind. Abel v. United States, 362 U. S. 217 (1960).

C. THE EVIDENCE WAS SUFFICIENT TO SUSTAIN THE VERDICT ON COUNT V.

1. The Evidence Established That Appellant Duran Was In Constructive Possession Of The Heroin Charged In Count V.

Appellant Duran argues that the evidence with regard to Count V is insufficient on two grounds: (1) that the evidence failed to establish any connection between Duran and his co-defendant Cruz and Guttierez, and (2) that the evidence failed to prove that Duran was in dominion and control of the narcotics seized at the Gales Motel.

The following evidence established Duran's connection with appellants Cruz and Guttierez:

(1) Alfred Ales testified that he and Robert Vasquez were employed by Duran to receive and conceal smuggled heroin pending Duran's directions as to the ultimate disposition of the heroin.

(2) Ales also testified that two male Mexicans would bring the narcotics into the county on a regular basis for Duran and that they would stay in motels in the El Monte-San Gabriel area.

(3) Ales also testified that on the morning of May 5, 1966, two male Mexicans delivered narcotics to Ales and Vasquez pursuant to Duran's instructions.

(4) Ales testified that after receiving delivery of the

heroin, he and Robert Vasquez divided the heroin pursuant to Daniel Duran's instructions. It was stipulated that of the twenty-nine condoms in Exhibit I-B, three condoms had fingerprints which were those of Robert Vasquez and Alfred Ales [R. T. 402].

(5) Ales testified that Robert Vasquez was employed by Duran to accept the delivery of smuggled narcotics from two male Mexicans who would bring the narcotics into the country on a regular basis and stay at motels in the El Monte-San Gabriel area.

Appellants Cruz and Guttierez brought 20 ounces of heroin into the country from Mexico. Appellant Cruz had the telephone number of Robert Vasquez on his person at the time that he was arrested and Robert Vasquez had the name of the motel, the address, and the room number where appellants Cruz and Guttierez were staying.

(6) Appellants Cruz and Guttierez were driving a vehicle registered to a Los Angeles address where officers had seen appellant Duran on several occasions.

(7) Appellant Guttierez and another male Mexican had commenced staying at the Gales Motel six months prior to May 11, 1966. According to the testimony of Mrs. Wise they came twice each month [R. T. 169]. Mrs. Wise also testified that Exhibit VII contained four registration cards for the months of March and April, 1966. Mrs. Wise observed appellant Guttierez sign each of the four cards always using a different name [R. T. 183].

It is submitted that Ales' testimony that Duran had employed two male Mexicans to bring narcotics into the country on a regular

basis, the fact that appellant Guttierez was a twice monthly visitor to the Gales Motel, the fact that appellant Cruz was found to have Robert Vasquez's telephone number in his possession at the time of his arrest coupled with the evidence that the car being driven by appellants Cruz and Guttierez was registered to an address where Duran had been seen on several occasions is sufficient to establish the requisite connection between all three appellants. As this Court has stated:

> "It must be noted that once the existence of a conspiracy is shown slight evidence is all that is required to connect the defendant with the conspiracy." Sabari v. United States, 333 F. 2d 1019 (9th Cir. 1964).

It is of course the rule that a jury can convict on the uncorroborated testimony of an accomplice.

Quiles v. United States, 344 F. 2d 490 (9th Cir. 1965);

Lyda v. United States, 321 F. 2d 788 (9th Cir. 1963);

White v. United States, 315 F. 2d 113 (9th Cir. 1963);

Bible v. United States, 314 F. 2d 106 (9th Cir. 1963).

2. The Evidence Is Sufficient To Sustain The Finding That Appellant Duran Had The Power To Exercise Dominion And Control Over The Heroin Found At The Gales Motel.

Appellant Duran argues that he may not be found to have had dominion and control over the narcotics because the evidence

did not show that he had actually paid for the narcotics. This argument, however, assumes that payment was to have been made only upon actual delivery. It is, of course, quite possible that at least partial payment had been made by Duran prior to its importation into the country. Appellants' argument also assumes that payment is a condition precedent to the exercise of dominion and control over a quantity of narcotics. This Circuit has stated that possession is that exercise of "dominion and control so as to give a power of disposal."

Arellanes v. United States, 302 F. 2d 603, 606 (9th Cir. 1962).

Clearly the jury found that Duran directed the importation of the narcotics into the country and that he had arranged for its transfer to Robert Vasquez. Thus Duran was in a position to exercise a power of disposal over the narcotics as it was continually subject to his discretion from the time of its entry into the country up until its final intended disposition.

3. The Evidence Sustains The Finding That Appellants Cruz And Guttierez Were In Joint Possession Of The Heroin Found Inside Their Motel Room.

Appellants Cruz and Guttierez argue that the evidence was insufficient to prove that they were in joint possession of the narcotics found in their room. Appellants' contention is that there was no evidence showing knowledge of either appellant that one or both

of them possessed the narcotics found inside the room.

The Government would submit that there was more than sufficient evidence to establish that appellants Cruz and Guttierez were engaged in a joint venture with regard to the heroin found in their motel room. The evidence established that on May 11, 1966, at 11:30 A. M., Audrey Wise, Manager of the Gales Motel in San Gabriel, cleaned Room 24. When she had finished, the waste-basket was in the bathroom where it belonged and it was empty. Exhibit 2-B (the 20 ounces of heroin) was not in Room 24 [R. T. 187, 188]. After cleaning the room she locked the door.

At 4:00 P. M., on May 11, appellants Cruz and Guttierez rented a room at the Gales Motel [R. T. 167]. Mr. Cruz and Mr. Guttierez had no baggage, clothing or personal toiletries. They were given Room 24. Only two keys existed for Room 24, the house key and the key given to Mr. Guttierez [R. T. 188]. The two appellants drove to the motel in a car belonging to Guttierez but being driven by Cruz.

At approximately 12:30 A. M., on May 12th, police officers proceeded to the Gales Motel and placed the two appellants under arrest. A cardboard card was seized from the person of appellant Cruz on which was written the telephone number of Robert Vasquez. Sergeant Sanchez searched Room 24. He was alone in the room with the two defendants during most of his search. He did not look under the writing table or observe any waste paper basket there as that was where the two appellants were sitting [R. T. 430].

When Sergeant Sanchez entered Room 24, it was locked.

When Sergeant Sanchez left Room 24, after arresting Cruz and Guttierez he locked the room [R. T. 239].

Later in the morning of May 12, 1966, Mrs. Wise unlocked Room 24 and entered for the purpose of cleaning. Under the writing desk, behind a chair was the bath room waste paper basket, laying on its side against the wall. The basket contained Exhibit II-B [R. T. 191, 192].

Clearly a question of fact was raised as to whether or not appellants Cruz and Guttierez were in joint possession of the heroin found inside their motel room. There was no heroin in Room 24 before Cruz and Guttierez arrived. When the Officers removed Cruz and Guttierez from Room 24, they locked the door. The door was still locked when Mrs. Wise entered and found the heroin.

In deciding whether Cruz and Guttierez were in joint possession of Exhibit II-B the jury may properly have considered appellants' testimony at the trial as indicating a consciousness of guilt. Both appellants Cruz and Guttierez testified. Their testimony was almost identical and may be considered as a whole. They testified that they had made only three trips to the United States, always together, and on each occasion they stayed at the Gales Motel [R. T. 377, 420]. This is contradicted by the testimony of Audrey Wise, the motel manager, who testified that for the six months prior to May 11, 1966, Mr. Guttierez and another male Mexican had been guests at the Gales Motel. They came twice each month, and on each visit, they stayed only one night [R. T. 169, 170]. Mrs. Wise testified that Exhibit VII contained four

registration cards for the months of March and April of 1966. She observed appellant Guttierez sign each card in Exhibit VII, always using a different name [R. T. 183]. Appellant Guttierez denied signing any of the four registration cards in Exhibit VII [R. T. 379, 380]. Appellants Cruz and Guttierez testified that they did not know anyone in Los Angeles, and in particular, they did not know Robert Vasquez or his telephone number [R. T. 122-125, 424]. This is contradicted by the fact that on May 11, 1966, Robert Vasquez had the name, telephone number and room number where appellants Cruz and Guttierez were staying. In addition, at the time of his arrest appellant Cruz had on his person the telephone number of Robert Vasquez. Appellant Cruz testified that he did not have Exhibit VIII on his person at the time of his arrest and further that he had never seen Exhibit VIII before [R. T. 424-426]. Officer Sanchez testified that Exhibit VIII contained the telephone number of Robert Vasquez and was taken from the pocket of appellant Cruz at the time of his arrest.

In deciding whether appellants Cruz and Guttierez may be found to have been in joint possession of the heroin found in Room 24 the case of Eason v. United States, 281 F. 2d 818 (9th Cir. 1960) is particularly applicable. In Eason the two appellants had been friends for about two years. On May 8, 1959, by mutual agreement, they traveled from their home in Ingleside, California, to Tijuana, Mexico. The two men drove to Tijuana in Eason's 1951 Dodge convertible. Appellant Nowlin provided the gasoline and food out of his funds. The two men arrived in Tijuana about

6:00 P. M., and were there until around 9:30 P. M. The appellants walked about Tijuana, went to a dog race and spent some time in a few cafes. They were together most of the time. Throughout their stay in Tijuana the car had been parked with the top down. As they were crossing the border on their return trip they were stopped because an inspector felt that they appeared nervous and because of their manner of answering questions. A search of the car produced a paper bag containing narcotics. The narcotics were found secreted behind the dashboard. Both appellants denied knowing that the narcotics were in the car. The Ninth Circuit affirmed the conviction holding that:

> "Possession can be established by circumstantial evidence . . . (citations omitted). Indeed, one might ponder long before discovering any other possible form of proof aside from admission." Id. at p. 820.

Further on the Court held:

> "As for the contention, advanced by each, that the other could have been the possessor, the evidence of close friendship, joint venture and general conduct were sufficient to warrant a reasonable jury finding beyond reasonable doubt that possession was joint." Id. at p. 821.

It is submitted that the record in the instant case clearly establishes that appellants were friends and associates engaging in a joint venture and that their general conduct and testimony were

sufficient to warrant a reasonable jury in finding beyond reasonable doubt that possession was joint.

D. THE EVIDENCE WAS SUFFICIENT TO SUSTAIN THE FINDING OF GUILT ON COUNT ONE.

1. The Court Properly Instructed The Jury With Regard to the Conspiracy Charge.

Appellants argue that the Court's instruction to the jury with regard to the conspiracy offense was defective in that in enumerating the essential elements of the conspiracy offense the Court did not include specific knowledge of illegal importation as one of the necessary elements. In considering appellants' contention the Court must consider the instructions as a whole to determine whether the jury was properly instructed with regard to knowledge of illegal importation.

Toward the beginning of the Court's instructions the jury was advised that they would be permitted to take the indictment into the jury room with them [R. T. 541]. They were then advised as follows:

"The only counts that you are to consider here are counts 1, 2 and 5 . . .

"Now under the law that is applicable here, which covers this situation, it provides as follows:

"Whoever fraudulently or knowingly

receives, conceals, buys, sells or in any manner facilitates the transportation, concealment or sale of any such narcotic drug after being imported and brought in knowing the same to have been imported or brought into the United States contrary to law . . . or whoever conspires to do any of the foregoing acts shall be guilty of an offense against the laws of the United States . . . " (Underscoring supplied) [R. T. 541].

Judge Carr then proceeded to instruct the jury separately on Count 1 and on Counts 2 and 5. Although he did not mention knowledge of illegal importation again in connection with Count 1 when he specified the particular elements of conspiracy, his comments earlier, together with the admonition that all the instructions should be considered together [R. T. 534], made it patently clear to the jury that knowledge of illegal importation was an essential element of the crime of conspiracy just as it was an essential element of the substantive crime under section 174.

Appellants rely on United States v. Massiah, 307 F. 2d 62 (2nd Cir. 1962), reversed on other grounds 377 U. S. 201 (1964). In Massiah, the trial court judge erroneously instructed the jury that defendant was charged under the general conspiracy statute, 18 U. S. C. 371, rather than under the conspiracy clause of 21 U. S. C. 174. Although the Second Circuit did not find this action standing alone to be prejudicial, it noted that the trial judge did

not at any time in his instruction on the conspiracy count advise the jury that knowledge of illegal importation was a requisite element of conspiracy. Moreover, and more significantly the court's instructions suggested to the jury that knowledge of illegal importation was not necessary for conviction. Thus, in reversing, the court in Massiah emphasized that the trial court not only failed to mention knowledge of illegal importation as an essential element of the crime but also indicated that it was not even an element of the offense.

The Second Circuit distinguished Massiah in United States v. Bentvena, 319 F. 2d 916 (2nd Cir. 1963), cert. denied sub. non Ormentio v. United States, 375 U. S. 940. In Bentvena, the trial court judge, at the beginning of his instructions to the jury, read the indictment which mentioned knowledge of illegal importation as an element of the crime. The trial judge then explained that the defendants were charged with conspiring to violate §§173 and 174 of Title 21 U. S. C. The Bentvena court observed that the above factual pattern differed from that which confronted the Massiah court. Although the trial judge in Bentvena set out 3 elements of knowledge of illegal importation, he repeatedly referred to the conspiracy "as charged in the indictment". Thus, the court in Bentvena concluded that the jury was sufficiently instructed as to this element of the crime.

The instant case shows a marked similarity to Bentvena. Although he did not read the indictment, Judge Carr read §174 to the jury which is tantamount to what the trial judge did in Bentvena.

Moreover, he allowed the jury to take a copy of the indictment into the jury room to be used during their deliberations. Unlike Massiah, Judge Carr did not charge the jury under the wrong statute, he did not in any way indicate that this element was not an essential requirement of the crime of conspiracy under §174. Thus the jury was sufficiently advised that the element of knowledge of illegal importation was an element of the crime and that a finding of the presence of this element was prerequisite to returning a guilty verdict on count 1.

2. The Evidence Was Sufficient To Sustain Appellants Cruz And Guttierez Conviction On The Conspiracy Count.

Appellants Cruz and Guttierez contend that the evidence failed to establish that they had entered into a conspiracy with appellant Duran and Robert Vasquez. The Government would submit that the evidence as set forth above clearly establishes that appellants Cruz and Guttierez were employed by appellant Duran to import narcotics into the country on a regular basis.

Particularly applicable to the conspiracy count is the case of Sandez v. United States, 239 F. 2d 239 (9th Cir. 1956). In the Sandez case an undercover agent of the Federal Bureau of Narcotics had been purchasing narcotics from a Vince Perno. In most of the contacts with the defendant Perno the telephone number PL 8-1879 was utilized. The undercover agent had information

that other unnamed persons were involved in the commission of the felony. On the last transaction the undercover agent was to acquire narcotics at a particular motel. At the time of this sale, an automobile bearing Baja California license plates was parked in the vicinity. Inside the motel room Vince Perno delivered the narcotics and was arrested. The occupants of the car from Baja California, were then arrested and for the first time identified as Sandez and Flores. Sandez was searched and on his person a business card of a Dr. Eloy Ovando, Tijuana. On the reverse side was written "Vince - PL-97818". This was the telephone number used by Vince Perno, provided that the numerals were read in reverse order. The search of Flores revealed a similar business card bearing on the reverse side a telephone number PL-81879. A search of Vince Perno revealed a business card of Dr. Eloy Ovando, Tijuana, on the reverse side was written Freddie Sandez with an address in Tijuana. There was no testimony as to who Freddie Sandez was or whether he was connected with the defendant Sandez. The Circuit Court held that " . . . there thus existed some substantial evidence to tie both Flores and Sandez into the conspiracy. This presented an issue of fact on which the jury was entitled to, and did, find adversely to the appealing defendant. There being substantial evidence in existence for the triers of fact to pass on, we cannot disturb that verdict on appeal . . . it is not for this court to reevaluate the evidence or substitute our judgment for that of the jury." Id. at 243.

Also applicable to the conspiracy charge in the instant case

is Diaz-Rosendo v. United States, 357 F. 2d (9th Cir. 1966). In Diaz-Rosendo, the indictment alleged a conspiracy to import marihuana and a substantive count of smuggling marihuana. The defendants were convicted of both counts. The Government's key witness was an accomplice who testified that a person in Mexico hired him to drive a car containing marihuana from Mexico to Los Angeles. The person in Mexico gave him a piece of paper on which was written a Los Angeles telephone number, the name Aspuro and Room 114. The telephone number was a motel where the defendants Diaz and Fernandez occupied Room 114, Room 114 had been rented in the name, Aspuro. The accomplice testified that after entry into the United States he called the telephone number and spoke to Aspuro. The accomplice stated he was having car trouble and a meeting was arranged. The defendants Fernandez and Diaz met the accomplice at a cafe. Defendants Fernandez and Diaz helped repair the accomplice's car. The accomplice then drove his car which contained marihuana. Diaz and Fernandez drove in their separate vehicle. Both cars drove the same route until an inspector attempted to stop both vehicles. The accomplice stopped his car but Diaz and Fernandez continued to drive on. Defendants Diaz and Fernandez contended that the evidence was insufficient. The Circuit Court affirmed the conviction noting that a part of the evidence was direct but the larger portion thereof was circumstantial and that conspiracy can rarely be proved other than by circumstantial evidence.

E. APPELLANTS WERE NOT DENIED EFFECTIVE ASSISTANCE OF COUNSEL.

1. Appellants Voluntarily Chose to be Represented by One Counsel and Were in no Way Prejudiced by the Exercise of that Right.

Appellants after having retained a highly qualified and experienced criminal trial lawyer, now contend that they were denied effective assistance of counsel because each had a "potential" defense of incriminating his co-defendant thereby exculpating himself. It is interesting to note that appellants use the term "potential defense" rather than "actual defense" because the record is quite clear that both Cruz and Guttierez set forth the entirely consistent defense that neither of them knew Robert Vasquez or Daniel Duran or had anything to do with the narcotics found inside their motel room. Perhaps had the appellants actually set forth defenses inconsistent with each others innocence they would now have some basis for asserting that a conflict of interest arose thereby depriving them of the effective assistance of counsel contemplated by the Sixth Amendment. However, to conjure up potentially conflicting defenses, out of a hat as it were, and then to argue that these felicitous conjurings constitute a basis upon which to set aside their convictions flies in the face of the record established by the appellants sworn testimony.

Appellants also allege that the trial court failed to

inquire affirmatively into possible conflicts of interest and insure that the choice to proceed with joint representation was a knowing one. This allegation again flies in the face of the record which shows that on not one but two separate occasions the court told trial counsel to inform the Court if there was the "slightest hint of conflict you had better be sure of it in advance before we come to trial." [R. T. 4, Vol. A.]

Appellants rely upon Glasser v. United States, 315 U.S. 60 (1942), in support of their contention that they were denied the effective assistance of counsel. In the Glasser case, supra, the Supreme Court of the United States declared that where a conflict of interests between co-defendants exists, joint representation by one attorney violates the Sixth Amendment right to effective assistance of counsel. The Court stated that the trial judge is charged with the duty to protect the constitutional rights of the defendant. Since the defense counsel had informed the trial judge of a possible conflict of interest, the Glasser court held that the trial judge had failed to exercise the proper concern for the basic rights of appellant in not informing him of his right to obtain separate counsel.

The Supreme Court noted the difficulty in determining the precise degree of prejudice suffered by the petitioner in sharing counsel with a co-defendant. However, the Court reversed, adjudging that appellant's defense would have been more effective had he been represented by separate counsel since (1) the liberal rules of evidence in conspiracy cases magnify the importance of assuring the undivided attention of counsel on behalf of a defendant, and

(2) the trial record revealed that counsel failed to cross-examine certain witnesses so as to develop Glasser's defense.

The appellants Duran, Guttierez and Cruz cite several cases arising from the District of Columbia Circuit. Since Glasser, the various Circuits have been confronted with the same problems on numerous occasions, and their decisions have not been unvarying.

In Campbell v. United States, 352 F. 2d 361 (D. C. Cir. 1965), the District of Columbia Circuit Court of Appeals, extending and elaborating the Glasser holding, ruled that,

> " . . . a trial judge has a responsibility to assure that co-defendants' decision to proceed with one attorney is an informed one." Id. at 361).

Thus, according to Campbell, the trial judge has the affirmative duty to apprise the defendants of the potential risks of joint representation, so that in choosing to be represented by one attorney he will have made an intelligent waiver of his right to the unimpaired assistance of counsel. In this case, the trial record did not indicate whether appellants were aware of the importance of retaining separate attorneys or of the danger inherent in joint representation. While the Campbell court did not attempt to formulate a standard by which to determine whether a criminal defendant had been prejudiced by sharing counsel with a co-defendant, it did find sufficient prejudice requiring reversal since (1) defense counsel made no effort to dissociate appellant Glenmore from his co-defendant, and (2) defense counsel did not raise the issue of the insufficiency of the evidence at

the close of the trial. The Court disregarded the possibility that the above strategic errors resulted from oversight by noting that if Glenmore had been represented by separate counsel he would have been able to cross-examine co-defendant Campbell on his testimonial assertions that he was in appellant's company during the entire evening of the commission of the alleged crime.

In Lollar v. United States, 376 F. 2d 243 (D. C. Cir. 1967), the District of Columbia Circuit was again called upon to determine whether joint representation of co-defendants violated Sixth Amendment rights and prejudiced appellant's defense. The Lollar court noted that the trial record did not indicate whether the district court judge considered the potential conflict of interests of the co-defendants, nor did it indicate whether it had advised them "of their right under the Criminal Justice Act (of 1964) to have separate counsel if their interests were so conflicting that they could not properly be represented by the same counsel." (Id. at 245). In view of these circumstances, no intelligent waiver by appellant could be inferred. Proceeding to the question of whether appellant was prejudiced by joint representation, the court in Lollar admitted that the federal circuits were divided on the question of determining what degree of prejudice was necessary for reversal. The court noted the Ninth Circuit decision in Lugo v. United States, 350 F. 2d 858 (9th Cir. 1965) as "apparently requiring a very strong showing of actual prejudice, while others suggest . . . the possibility of prejudice is sufficient." Id. at 246 & n. 7). The Lollar court adopted the latter view:

"We hold, therefore, that only where 'we can find no basis in the record for an informed speculation' that appellant's rights were prejudicially affected 'can the conviction stand. . . .'

"In effect, we adopt the standard of 'reasonable doubt', a standard the Supreme Court recently said must govern whenever the prosecution contends the denial of a constitutional right is merely harmless error." (Id. at 247).

The court found three weak evidentiary pegs on which to base its conclusion that appellant might have suffered possible prejudice: (1) co-defendant's testimony referring to appellant (a male adult) in the feminine gender might have created an adverse impression on the jury but counsel failed to object (the court ignored the fact that appellant's defense was based on his claim of a homosexual relationship with co-defendant); (2) appellant testified at trial and thus the Government was able to elicit evidence of his prior criminal record for impeachment purposes. The court in Lollar believed that this strategic decision would not have been made if counsel had been solely concerned with appellant's defenses; and (3) counsel confused the names of Lollar and co-defendant Ford during the trial proceedings. The District of Columbia Circuit essentially reaffirmed its holding in Lollar in Ford v. United States, 379 F. 2d 123 (D. C. Cir. 1967) where the appellant Ford was the co-defendant of defendant Lollar. However, the Ford court went a step farther than Lollar by

enunciating the rule that hereafter, under the aegis of the Criminal Justice Act of 1964 (18 U. S. C. 3006 (A)(b)) [3/] the trial courts of the District of Columbia Circuit shall initially appoint separate counsel for each co-defendant. Only if counsel believes no conflicting interest exists or is possible, and only if defendants make an intelligent waiver, will joint representation by one counsel be allowed. While every case turns on its particular facts, the opinions of the District of Columbia Circuits differ materially from those issued in the Ninth Circuit. The Ninth Circuit -- as the Lollar court noted -- has heretofore required a showing of actual prejudice before it will determine that a defendant's right to effective assistance of counsel has been violated by joint legal representation.

In Lugo v. United States, 350 F. 2d 858 (9th Cir. 1965), this Circuit noted the following language from Glasser:

> "The right to have assistance of counsel is too fundamental and absolute to allow courts to indulge in nice calculations as to the amount of prejudice arising from its denial." (Glasser v. United States, supra, at 76).

However, the Lugo court rejoined that:

> "[N]either can we create a conflict out of mere conjecture as to what might have been shown." (Id. at 850).

3/ "The United States Commissioner or court shall appoint separate counsel for defendants who have such conflicting interests that they cannot properly be represented by the same counsel."

In Kaplan v. United States, 375 F.2d 895 (9th Cir. 1967), cert. denied 389 U.S. 839, the Ninth Circuit upheld the convictions of defendants who argued on appeal that joint representation violated their Sixth Amendment rights. Before trial, counsel for the defense indicated that no conflict of interest existed. In rejecting the appellants' contention, the Kaplan court stated that:

> "In determining this question (of conflict of interest), the trial court must be able, and be freely permitted, to rely upon counsel's representations that the possibility of such a conflict does or does not exist. The necessary adequate representation by an attorney which the law requires implies that the court may rely on the solemn representation of a fact made by such attorney as an officer of the court. The court may go further into the factual situation if he desires, but is under no original or continuing obligation to do so." (Id. at 897).

Moreover, each defendant was found to have made an intelligent waiver of his right to separate counsel. The Kaplan decision illustrates the more stringent standard of the Ninth Circuit in requiring a showing of actual prejudice in contrast to that employed by the District of Columbia Circuit. Noting appellants' admission in their brief of their inability to show actual prejudice, the Kaplan court concluded that on appeal the Ninth Circuit will not,

> "Speculate whether or not there could have existed

some other possible conflict of interest not factually disclosed, or even suggested by a careful reading of the record before us." (Id. at 898 & n. 5).

The Ninth Circuit reached the same result in Juvera v. United States, 378 F. 2d 433 (9th Cir. 1967), cert. denied 389 U. S. 1008. In Juvera, the defendants contended that the trial judge erred in failing to inform them at the commencement of trial of the possible conflict of interests involved in having one attorney present their defenses. The Ninth Circuit court rejected this contention, holding that the trial judge has no such duty or obligation (Id. at 437).

Accord: Kruchten v. Eyman, 276 F. Supp. 858, 860 (D. C. Arizona 1967);

See also: Peek v. United States, 321 F. 2d 934, 944 (9th Cir. 1963), cert. denied 376 U. S. 954 (1964);

Gonzales v. United States, 314 F. 2d 750 (9th Cir. 1963).

In the instant case the record is clear that the trial court twice inquired of appellant's trial counsel whether any conflict of interest existed. Both times trial counsel responded that there was no conflict. The court properly relied on trial counsel's representations. Furthermore, appellants have made no showing of actual prejudice brought about by virtue of their joint representation. It follows that appellants were in no way denied the effective assistance of counsel as contemplated by the Sixth Amendment.

2. Trial Counsel's Trial Strategy Did Not Deprive Appellants of the Effective Assistance of Counsel.

Appellants now argue that if they are deemed to have waived their right to object to the admissibility of certain evidence then the ineffectiveness of their trial counsel has been established. A careful review of the record, however, establishes that such is not the case.

Basically we are dealing with trial counsel's strategy with regard to the searches of May 6, 1966, and May 12, 1966. In connection with the search of May 6, 1966, appellants' trial counsel sought to suppress the testimony of the accomplice Alfred Ales. He filed a lengthy motion and an affidavit of appellant Duran. While it is true that counsel at no time, either before, or during trial, ever made a Rule 41(e) motion with regard to the seizure of the heroin found in Ales' motel room, it is clear that this was a tactical decision on the part of an experienced federal criminal trial lawyer and in no way reflects inadequate preparation on the part of counsel.

With regard to the search of the Gales Motel on May 12, 1966, trial counsel did interpose a belated objection to the search of Room 24. His explanation for the lateness of his motion was that while he had been made aware of the circumstances surrounding the search he did not feel that it was relevant until the moment at which he made his objection. Clearly this negates any allegation of inadequate preparation. Mr. Marcus was made aware of the facts of the search long prior to trial but these facts did not, in his best judgment, became relevant until the moment at which he objected.

In effect the rule that appellants contend for is that any time trial counsel is deemed to have waived any motion he therefore becomes ipso facto, incompetent. A rule such as the one contended for by appellants would leave virtually every record open for a collateral attack should a reviewing court refuse to consider an objection raised for the first time on appeal. It is significant to note that in none of the cases cited by appellee in which a reviewing court held a waiver of the right to make a Rule 41(e) motion was counsel therefore deemed to be incompetent. We submit that trial counsel in the instant case pursued a well planned trial strategy and that to subject him to an allegation of incompetency merely because the jury convicted is unjustified by the record and under the prevailing cases.

F. THE TRIAL COURT IN NO WAY DENIED APPELLANTS A FAIR TRIAL.

Appellants contend that the trial court made frequent remarks which tended to disparage defense counsel thereby depriving appellants of a fair trial. Appellants then proceed to cite numerous colloques between the court and defense counsel and argue that these prejudiced appellants.

It is significant to note that a great many of the comments referred to by appellants which they claim disparaged and deprecated their defense were made outside of the presence of the jury and therefore in no way could have affected the jury verdict (Appellants' Brief, pp. 91, 92, footnote 6, p. 86, footnote 7).

It is also important to note the numerous times during the course of the trial that the court instructed the jury to disregard the court's comments. The following references are cited merely to direct this Court's attention to the careful manner in which the trial court instructed the jury in that regard. At R. T. 17, the court instructs the jury to disregard the court's comments on the law; at R. T. 38, the court instructs the jury that when the court makes a ruling or comment it is not evidence and they are to disregard it; at R. T. 71, the court instructs the jury that "my comments to counsel are not evidence and they should not persuade you in any way in connection with this case"; at R. T. 278, the court instructs the jury to disregard the statements of counsel and the court; at R. T. 360, the court instructs the jury to disregard the court's remarks; at R. T. 399, the jury was instructed that, "what the lawyers say and what the Court says, except when the Court is giving you the law, can be completely disregarded and should be disregarded by you. Pay no attention to it at all"; at R. T. 465, the jury was instructed that "if the Court has criticized counsel it has absolutely no bearing on the case"; at R. T. 534, during the court's final instructions to the jury he carefully charged them that,

> "Any comments by the Court or by counsel are not evidence. And if this Court has come out and said something that has given you any impression at all as to the guilt or innocence of these defendants, you are not only at liberty to disregard it, you are duty-bound by your oath to disregard it if

your conscience speaks to the contrary, because, I repeat, you are the sole judges of the facts."

Finally, at the conclusion of the final instructions the jury was instructed that "any remarks by the Court, if you considered them to be a bit harsh toward one of the other counsel, forget them. They have no bearing in your consideration of the case." [R. T. 556].

We submit that a careful reading of the transcript indicates that the trial court carefully protected the appellants' rights with frequent instructions to the jury to consider only sworn testimony as probative evidence.

Appellants also contend that the trial court's denial of their motion to suppress the testimony of Alfred Ales and his remarks with regard to the Miranda case denied them a fair trial in that their defense was disparaged in the eyes of the jury. Had Ales been deemed constitutionally unqualified to testify appellants' point might be well taken. Then the point could well be made that the jury might have speculated with regard to the nature of the obviously incriminating testimony that they were not being permitted to hear. But in the case at bar the jury was permitted to hear Ales' testimony. They were not deprived of any testimony and were under no compulsion to speculate as to what the nature of the suppressed testimony might have been. We submit that the court's denial of appellants' motion to suppress Ales' testimony coupled with the court's instructions to the jury to disregard the court's comments on the law adequately protected the appellants' rights and in no way denied them a fair trial.

G. THERE WAS NO MULTI-COUNT PREJUDICE IN THE INSTANT CASE WHICH WOULD REQUIRE A REVERSAL OF THE JUDGMENT OF CONVICTION.

Appellants argue that if this Court finds that any error was committed with regard to any one count of the indictment the entire case must be reversed because "the charges are so interrelated that it cannot be said that an error as to one count did not raise a reasonable possibility that the evidence complained of might have contributed to the conviction on other counts." (Appellants' Brief, p. 100). Clearly this is not the law. In a multi-count conviction, if concurrent sentences are imposed, the judgment of conviction will stand if any one count is sustained. Hirabayashi v. United States, 320 U.S. 81 (1943). Furthermore, a close scrutiny of the record does not disclose such an inextricable interrelationship between counts.

The only errors complained of by appellants that would of necessity affect the entire trial would be (1) that they were denied the effective assistance of counsel and (2) that the trial court's conduct was so prejudicial as to deny appellants a fair trial. Clearly, any of the other alleged errors, if such there were, would affect only the count to which they were related.

For example, if the seizure from Alfred Ales' motel room is deemed to be lawful then Count 2, with regard to appellant Duran, must be sustained regardless of the legality of the search and seizure at appellants Cruz and Guttierrez motel room on May 12th. The

testimony of Alfred Ales with regard to Count 2 would be enough, standing by itself, to convict appellant Duran even if it were not corroborated. Quiles v. United States, supra. However, the instant record discloses that Ales was corroborated on many significant parts of his testimony, perhaps the most important of which was that Ales testified that he was expecting appellant Duran to contact him on May 6th with regard to the disposition of the 24 ounces of heroin Ales was holding for Duran. On the evening of the 6th Officer Sanchez observed Duran enter Ales' residence and stated to him, "have you got it?"

We would submit that if any error was committed with regard to either of the searches in question that error must be limited to the related count.

Courtney v. United States, No. 20,769 (9th Cir. March 1, 1968, Slip Sheet Opinion).

Appellants cite Chapman v. California, 386 U.S. 18 (1967) and Fahy v. Connecticut, 375 U.S. 85 (1963) and argue that "in a narcotic case such as this involving substantive counts and a conspiracy count, the error cannot possibly be considered harmless" and that, therefore the Government cannot prove beyond a reasonable doubt that the error complained of did not contribute to the guilty verdict. Yet in Chapman v. California, supra, the Supreme Court held that not all constitutional errors require reversal.

> "We conclude that there may be some constitutional errors which in the setting of a particular case are so unimportant and insignificant

that they may be, consistent with the Federal Constitution, be deemed harmless, nor requiring the automatic reversal of the conviction."

Id. at 22.

In the case at bar the two searches in question are the subject of two separate substantive charges unlike the situation in the Chapman and Fahy cases supra, where the defendants were charged in single count indictments and any error must, of necessity, have affected the convictions. We would submit that each count in the instant indictment is supported by substantial independent evidence and should stand or fall by itself, regardless of the determination as to the other counts.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of conviction of appellants Duran, Cruz and Guttierez should be affirmed.

Respectfully submitted,

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No. 22348

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FOR THE NINTH CIRCUIT

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JO ANN SULLIVAN,

Appellants,

vs.

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and RICHARD L. OLIVER, dba
MULLINS, SLOANE & OLIVER CO.,

Appellees.

ON APPEAL FROM
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OPENING BRIEF OF APPELLANTS

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Appellees.

OPENING BRIEF OF APPELLANTS

The within cases began with Creditor's Petitions alleging Acts of Bankruptcy filed in the United States District Court For The Central District Of California by the Appellees against the Appellants. (Page 2 of Transmitted Record.)

Section 2 a(1) of the Bankruptcy Act vests the Courts of Bankruptcy with jurisdiction to adjudge persons bankrupt:

(1) "Who have their principal place of business, resided or had their domicile within their respective territorial jurisdictions for the preceding six months . . ."

Bankruptcy Act Section 1 (10) "Courts of Bankruptcy shall include the United States Courts . . ."

STATEMENT OF THE CASE

Appellants rented a store under a written lease for the purpose of operating a laundromat from the appellees as landlords, said appellees being a partnership.

The particular question involved is whether the acts of the appellees in taking possession of the leasehold premises, resulted in a termination of the lease contract and the tenancy.

The further question is whether the appellees had the right to make an election of remedies more than once.

The eviction becomes important for the reason that it determines the amount of rent owed, and if it be true that only $253.09 in rent was owed, the Bankruptcy Court would not have jurisdiction to declare appellants' bankrupt.

I

THE APPELLEES AS LANDLORDS MADE AN ELECTION OF REMEDIES IN TAKING POSSESSION

When appellees took possession of the demised premises by changing the locks on August 9th, 1966, or August 19, 1966, this was an eviction of the appellants as lessees (Rep. Tr. pp. 11,

14-19).

As a matter of common sense, only the appellees would benefit by excluding the appellants from the premises, and then the appellees as lessors, did take over the possession and control of the property. Thereby enabling appellees to rent to another tenant. No one else would benefit by such action, and it is not encumbent upon the appellants to prove beyond a reasonable doubt, that either the lessor or those acting under them changed the locks on the laundromat machines so as to exclude appellants from the beneficial use of the premises.

The law is very clear that any eviction, constructive or otherwise, terminates the lease, and we must give the necessary weight to our underlining of Civil Code §3308, "by reason of any breach thereof, by the lessee." Unless the breach was by the lessee, the lessor does not have all the rights, remedies and options that appellees here contend that they have. Nor do they have those rights by simply ignoring the fact that someone acting for or on behalf of the lessor, the appellees herein, did effectually evict the appellants from the premises on August 9, 1966, or on August 19, 1966. The law is clearly stated in the case of Sierad v. Lilly (1962), 204 Cal. App. 2d 770 where the Court held:

> "Any disturbance of a tenant's possession by a landlord or one acting under his authority, whereby the premises are rendered unfit for

occupancy for the purpose for which they are demised, or the tenant is deprived of the beneficial enjoyment of the premises, amounts to a constructive eviction."

The only proper action to be taken by the appellants upon their eviction on August 9, 1966, was to abandon the premises, to order the utilities cut off, and at least the appellants knew that they were on the outside looking in, (Rep. Tr. pp. 43 and 54).

The tenants had no other choice but to abandon the premises as was held in Sanders v. Allen (1948), 83 Cal. App. 2d 362, where the Court said:

"Except in the case of a partial eviction, the tenant must then abandon the premises within a reasonable time, if he wishes to terminate the liability."

In the within cause, the appellants did desire to terminate the liability under the lease, and as a result of the actions of the landlord, or those acting for him, they were then forced to abandon the premises, whereupon the lease was terminated.

Only the appellee as the landlord herein, would benefit by the changing of the locks upon the machines of the laundromat, and therefore we can only conclude that the act was done by the landlord, or for their benefit by their agents or representatives.

The above reasoning is clearly set forth in the case of Groh v. Kover's Bull Pen Inn (1963), 221 Cal. App. 2d 611

wherein the Court held:

> "A constructive eviction occurs when the acts or omissions to act of the landlord, or any disturbance or interference by the landlord, renders the premises, or a substantial portion thereof, unfit for the purposes for which they were leased, or which has the effect of depriving the tenant for a substantial period of time of the beneficial enjoyment of use of the premises."

Appellee places great stress upon Calif. Civil Code §3308 (added in 1937). A careful reading and analysis of that section clearly illustrates why appellees claim in this action for involuntary bankruptcy is invalid. Civil Code §3308 provides as follows:

> "The parties to any lease of real or personal property may agree therein that if such lease shall be terminated by the lessor by reason of any breach thereof by the lessee, the lessor shall thereupon be entitled to recover from the lessee the worth at the time of such termination, of the excess, if any, of the amount of rent and charges equivalent to rent reserved in the lease for the balance of the stated term, or any shorter period of time over the then reasonable rental value of the premises for the same period."

Clearly the acts of the appellants in this case comes under the holding in Standard Livestock v. Pentz (1928), 204 Cal. 618, 269 Pac. 645 wherein the Court held:

"Eviction, actual or constructive, constitutes breach of the covenant of quiet enjoyment."

California Civil Code §1927.

Further to avoid a technical surrender the lease must provide that the lessor may re-rent for the lessee after notice of such intent or with notice waived. In this case the lessors did not give any notice, but merely stated in a letter prior to any action being taken that landlord intended to exercise some of their rights of some remedies under paragraph 21 of the lease (Rep. Tr. p. 34).

It is appellants' position that the landlord did not clearly set forth in writing what remedies were to be exercised under any of the provisions of the lease. The eviction was an election. Having made an election of remedies, if there is any change in position, the tenant should have been notified by the landlord. The following cases outline the law applicable under these circumstances in which a landlord is attempting to accelerate the payment of rent and to take upon himself rights which he is not legally entitled to.

In the case of Ricker v. Rombaugh (1953), 120 Cal. App. 2d Supp. 912 the Court held:

"Provisions for acceleration of rent for the balance

of the term are unenforceable penalties."

In Jack v. Sinsheimer (1899), 5 Cal. 563, 58 Pac. 130, the Court held:

"Liquidated damages provisions have been held unenforceable on the ground there is acertainable actual damages."

The Ricker v. Rombaugh case, supra, further held:

"In the case of rent, an acceleration would require the tenant to pay for that which he has not received. Hence the provision in a lease for acceleration of rent on breach of the covenant to pay rent is void and unenforceable as being either an agreement for liquidated damages when the damages are readily ascertainable or constituting a provision for penalty. This is particularly true in a case where the lease contains a provision that the rent acceleration is in addition to any other remedy the lessor may have."

The attempt of the appellees here to accelerate their action for rent comes clearly within the holding in Tillson v. Peters (1953), 41 Cal. 2d 671, where the Court held:

"The right of action for rent accrued when each installment of rent becomes due. Hence the statute of limitations starts running against it at that time."

The lessors having failed to come properly within the provisions of the lease in this case, we must be governed by the holdings in the cases of Bradbury v. Higginson (1912), 162 Cal. 602, 123 Pac. 797, Oliver v. Loyden (1913), 163 Cal. 124, 124 Pac. 731.

> "Rent does not become payable until it falls due under the lease, though the tenant may have abandoned the premises. The repudiation of the lease by the lessee does not operate to mature further installments of rent."

Now, we should look to the second paragraph of Civil Code §3308, as to the remedies of the landlord. The second paragraph sets forth:

> "The rights of the lessor under such agreement shall be cumulative to all other rights or remedies now or hereafter given to the lessor by law or by the terms of the lease; provided, however, that the election of the lessor to exercise the remedy hereinabove permitted shall be binding upon him and exclude recourse thereafter to any other remedy for rental or charges equivalent to rental or damages for breach of covenant to pay such rent or charges accruing subsequent to the time of such termination." (underlining ours).

The letter of August 5, 1966, directed to the tenant by the landlord stated that:

> "This notice is given to you pursuant to the provisions of paragraph 21 of our lease with you, and you are further reminded that under such paragraph if you do not cure this breach and default within ten days we as landlords shall be entitled to and propose to exercise the various remedies provided for in said paragraph."

In this case ten days would have been up on August 16, 1966, but we have shown that on August 9, 1966, all the locks on the machines were changed by the landlord or someone acting for the landlord, and thus effectually excluding the tenants from the premises. Having elected the one remedy of eviction, the landlord could not thereafter exercise other remedies; particularly where no written notice was given to the tenant after the August 5, 1966 letter (Rep. Tr. pp. 31, 32 & 34). The Code section clearly provides that the election of the lessor to exercise the remedy hereinabove permitted shall be binding upon him, and exclude recourse therefor to any other remedy for rental or charges, and this was the landlord's election and the exclusive exercise of his remedies, as the tenant never was given written notice of the lessors exact intentions.

It cannot be contended that in the face of § 3308 of the Civil Code that the landlord could go on and on, electing,

selecting and exercising various remedies all under a vague illusion to §21 of the lease, and without any notice to the tenant.

The lease having been terminated by the landlord, and the only amount due and owing at that time was $253.09, the appellees here cannot bring themselves within the provisions of the bankruptcy act. It is very clear in this case that the landlord exercised his rights and his remedies as he admits on August 19, 1966, by putting the locks on the outside doors. Then having locked up the machines on the inside on August 9, 1966, so as to preclude the tenant from using the premises, the lessor elected that remedy and not having thereafter given any written notice to the tenant as to what the landlord intended to do for the benefit of the lessee. The landlord must be held to have exercised his remedy by taking possession of the premises and cannot now pursue other remedies.

II

THE RENT OWED WAS LESS THAN THE JURISDICTIONAL AMOUNT.

Appellants and their attorneys are in error in admitting in the answer that they owed three months rent for June, July and August of 1966, actually under the authorities cited below when the lessor acted to deprive the tenants of the use of the premises on August 9, 1966, the rent must be apportioned for

the month of August, 1966, for as is held in the cases of Ohsaki v. Hearn (1927), 85 Cal. App. 199, and Friedman v. Isenbruck (1931), 111 Cal. App. 2d 326 where the Court held:

"Rent can be apportioned when the tenant was evicted through the wrongful act of the lessor."

Therefore, rent was due and payable at approximately $11.66 per day, which would make a total of $104.94 due from August 1 to August 9, 1966, and rent to the date of the eviction would be due and owing to the lessor, and the recomputation shows that only $253.09 was due and owing to the appellees from the appellants at the time the petition was filed. Appellants' answer to petition on page one, paragraph II should be amended to show $253.09 as being owed to the lessor.

III

APPELLEES AS LANDLORDS DID NOT GIVE THE REQUIRED NOTICE TO APPELLANTS

Appellees place great stress on the letters of August 5, 1966, in which the attorneys for appellees wrote to tenants:

"Our client, Madison Way Shopping Center, has addressed to your client, Daniel Sullivan, a notice pursuant to paragraph 21 of the lease in said shopping center between the aforementioned parties."

The letter sets forth the purported delinquency in the rents and the letter from Madison Way Shopping Center says:

> "Your breach consists of your failure to pay rents due on the first day of each month, for the months of June, July and August 1966, this notice is given to you pursuant to the provisions of paragraph 21 of our lease with you and you are further reminded that under such paragraph if you do not cure this breach and default within ten days, we as landlords shall be entitled to and propose to exercise the various remedies provided for in said paragraph."

Based on this vague reference to paragraph 21 and the various remedies, appellees take the position that although appellants were not evicted until August 9, 1966, or August 19, 1966, that this gave the appellees the right to re-let the premises without further notice, to re-let the premises for a different rental, and appellees need not give notice of their intentions to the lessees; also that the new lease may extend beyond the original term without further notice.

Appellants submit that on August 5, when the letters were written, none of these remedies were known or could be known to the appellants' and no effective action was taken until appellees evicted the lessees from the beneficial use of the premises. Thereafter no other notices or letters of any kind were sent to

the lessees by the lessors. To expect the lessees to know which of the various remedies under the vague paragraph 21 of that appellees may elect is an impossible situation, and a tenant has a right to know what the landlord is doing that might result in an obligat ion to pay on the part of the tenant. The two letters of August 5, 1966 Exhibits "A" and "B", are part of Memorandum of Points and Authorities (Cl. Tr. p. 72). At the time the letters were written no action had been taken by the landlord and it was not until August 9th, or August 19, 1966 that the landlord elected one remedy and that was to physically evict the tenant from the premises. No other remedies are available to the lessor under Calif. Civil Code §3308 after exercising his right to evict the tenant.

Appellants contend that they were entitled to written notice from the lessors of their intention to re-let the premises for the benefit of the tenant and for what term and for what amount of rent.

The law is clearly set forth in the cases of DeHart v. Allen (1945), 26 Cal. 2d 829, Kulawitz v. Pacific (1944), 25 Cal. 2d 664, Ace Realty Co. v. Friedman (1951), 106 Cal. App. 2d 805, in which the case is held as follows:

> "A lessor may elect to take possession for the account of the lessee, lease the premises for the account of the lessee, lease the premises for the unexpired term, and sue the tenant for the deficit

for the balance of the term. The lessor must give the tenant information that he is accepting the possession for the lessee's benefit and not his own right and his own benefit."

If the lessor takes possession unqualifiedly, he thereby releases the tenant. The actions of the prepondent herein making the eviction as appellants contend, the actual eviction was made by the landlord either on August 9, 1966 or August 19, 1966, however, the appellants position is that no actual eviction occurred until August 19, 1966. In neither case did the landlord give written notice of his intentions to elect to re-let for the tenants' benefit for the greater term or for a different rent.

At the time the letters of August 5, 1966 were written, the landlord had not elected what remedy he intended to take, and the appellants had the right to believe that the actual eviction by the changing of the locks was the only remedy the landlord had elected, because thereafter he did not receive any other written notices or letters from the lessors (Rep. Tr. p. 34).

The landlord having written a letter on August 5, 1966 did not tell the tenant anything as to the remedies or what position the landlord would take; the lessor went outside the lease as to the special provisions and is bound by the general law.

In Dorosch v. Time Oil Co., (1951), 103 Cal. App. 2d 677, 683, the Court held:

"The landlord must notify the tenant of his intention to re-let for his benefit. If he fails to give notice, his repossession is deemed inconsistent with the lease, and results in the surrender by operation of law, releasing the tenant."

In this case the landlord having failed to give notice of what remedies he intended to exercise under paragraph 21 of the lease, would have to give prompt written notice of his intentions before a re-letting or making a new lease.

The within cause shows a breach of the lease by the landlord in placing locks either on the machinery equipment of the tenant or upon the doors, and the covenant of quiet enjoyment having been breached the lease is terminated.

These cases set forth herein below hold as follows:

"In every lease there is an implied covenant by the lessor of quiet enjoyment and possession during the term." Civil Code (1927)

Baranov v. Scudder (1928), 177 Cal. 458;

Pierce v. Nash (1954), 126 Cal. App. 2d 606, 612, 24 Cal. L. R. 454.

The landlord having failed to notify the tenant in writing after the purported breach of the lease which remedy he would

elect. He cannot accelerate the rent. The case of Goldmining v. Swinerton (1943), 23 Cal. 2d 1932 holds as follows:

> "The landlord cannot, on a theory of anticipatory breach, recover future installments, or the entire balance in advance. If he stands on the lease, and treats it still as in existence, no obligation to pay the rent arises until the installments fall due."

RECAPITULATION

1. Forcible eviction thus terminating the lease.
2. The provision for recovery of the rent is a penalty.
3. The number of creditors were not enough to file the petition.
4. The failure to properly elect remedies.
5. The amount of the total debt is not sufficient for filing the petition.
6. The preparation of the findings of facts and conclusions of law does not constitute adoption of those findings.
7. The Court had no power to find what was the reasonable rental value to the end of the term for this issue was not raised.
8. The findings that the locks were not changed by the lessor is patently absurd.

A lessor had no right to dispossess his lessee forcibly without legal process despite a breach of covenant. Fox v. Brissac, 15 Cal. 223; Eichorn v. Dela Cantera, 117 Cal. App. 2d 50.

This is true though the lease contains a provision for entry in case the rent is not paid. Igauye v. Howard, 114 Cal. App. 2d 122.

The right to repossess should be exercised only where it can be done peaceably and without force or violence. If it cannot, the lessor must resort to the courts. Calidino Hotel Co. v. Bank of America, 31 Cal. App. 2d 295.

To warrant re-entry under a provision for re-entry on default of rent or performance of covenants the lessor must give statutory notice. Lydon v. Beach, 89 Cal. App. 69.

The lessor must not use forcible means to effect an entry. Igauye v. Howard, 114 Cal. App. 2d 122.

A lease provision that authorizes the lessor on default to terminate the lease and re-enter the premises and at the same time to sue for unpaid rent reserved for the entire term has been held to constitute a provision for a penalty and as such to be unenforceable. Ricker v. Rombough, 120 Cal. App. 2d Supp. 912.

Among acts held to constitute an eviction (1) the taking of possession without the lessee's consent, (2) reletting to another; Boswell v. Merrill, 128 Cal. App. 476; (3) Breaking

locks on gates and doors, Saferian v. Baer, 105 Cal. App. 238.

CONCLUSION

The appellees in this case, one creditor with only a claim for $253.09, do not comply with the Bankruptcy Act so as to give the referee the authority to adjudicate the appellants as bankrupts.

Respectfully submitted,

COURTNEY & COURTNEY

By: /s/ Norman P. Courtney

Attorneys for Appellants

CERTIFICATE

I certify, that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Norman P. Courtney

NORMAN P. COURTNEY

No. 22348

IN THE

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On Appeal From the Judgment of the United States District Court for the Central District of California

---

BRIEF OF APPELLEES

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BRIEF OF APPELLEES

Opinion Below

The opinion below is set forth in the Referee's Memorandum Decision (Transcript of Record, pp. 60-61) and Findings of Fact and Conclusions of Law (Transcript of Record, pp. 62-65) and Judgment and adjudication in bankruptcy (Transcript of Record, p. 66).

JURISDICTION

Appellees agree that this Court has jurisdiction to hear this matter; however, "Appeals under this Act to the United States Court of Appeals shall be taken within thirty days after written notice to the *aggrieved* party. . . ." (11 USC § 48) (Emphasis added)

Are either of the alleged bankrupts, Daniel D. Sullivan or Jo Ann Sullivan, also known as "Joe Barker", "aggrieved" by the adjudication (1) that they are indebted to petitioners in the sum of $7,908.83 (plus certain additional sums)?, and (2) that they are bankrupt? The answer to both of these questions is no, for as is shown by the Transcript of Record, pp. 94-97, the alleged bankrupts *asked that the Referee in Bankruptcy sign the Conclusions of Law which they had set forth therein.*

Included in the Conclusions of Law of alleged bankrupts were the following: "[T]herefore, lessees owe to lessors the following amounts: . . . total $7908.83" (Transcript of Record, p. 96); the bankrupts further admit that "within four months next preceding the filing of this petition, respondents and each of them did commit an act of bankruptcy . . ." (*Ibid.*) Further, the bankrupts' attorney stated that they, the alleged bankrupts, "concealed a part of their property with intent to defraud creditors" and that "respondents and each of them are bankrupt." (*Ibid.*)

In summary, appellees submit that alleged bankrupts cannot be aggrieved under Section 25 of the Bankruptcy Act (11 USC § 48) because they submitted the Findings of Fact and Conclusions of Law in which alleged bankrupts admit that they owe the monies for which petitioning creditors obtained a judgment, further admit that they transferred a property with intent to defraud credi-

tors, and further admit that they are bankrupt. Since he "who consents to an act is not wronged by it" (CAL. CIV. CODE § 3515), appellants herein are not "aggrieved," and they should not be heard on appeal.

ARGUMENT OF THE CASE

Although appellants do not list a specification of errors, the latters' "STATEMENT OF THE CASE" (Brief of Appellant, p. 2) lists two questions:

1. Did the acts of appellees in taking possession of the premises result in a termination of Appellees' (Lessors') rights under the Lease?

2. May Lessors seek damages against an evicted Lessee?

Both of these questions are discussed below.

I

DID THE ACTS OF APPELLEES IN TAKING POSSESSION OF THE PREMISES RESULT IN A TERMINATION OF APPELLEES (LESSORS) RIGHTS UNDER THE LEASE?

Appellees owned and operated a shopping center and leased one of the store buildings therein to alleged bankrupts, in which the latter conducted a coin operated laundry business. The Lessees failed to pay rent of $350.00, plus parking lot fees of $15.00 per month, due on the first day of each of the months of June, July, August, September and October, 1966. On August 5, 1966, the lessors gave notice of default for such failure, which notice contained a statement to the effect that if

default was not cured, lessors would exercise all rights granted to them under paragraph 21, entitled "Default" of the aforementioned lease.

On August 9, 1966, the lessees abandoned the premises. On August 10, 1966, lessees ordered the power company to turn off the electricity which was done August 11, 1966. On August 19, 1966, informed that the leased premises were littered with debris and in a state of disorder, lessors changed the locks on the front and back doors, and repaired the broken plate glass door; on November 1, 1966, lessors relet said premises for the sum of $300.00 per month plus $15.00 parking lot maintenance fee, or $50.00 less per month than appellants, lessees, had been paying.

To try to establish that the acts of appellees in taking possession did result from a termination, the appellants, *on appeal,* argue that appellees, on August 9, 1966, changed each lock on each laundry machine and therefore that appellees evicted the appellants from the premises. Such argument is one of fact, and neither the Findings of Fact and Conclusions of Law, nor the Referee's Memorandum Decision (Transcript of Record, pp. 51-52), nor the Referee's Certificate on Petition for Review of an Order Declaring an Alleged Bankrupt to be in Fact Bankrupt (*Id.,* 68-71), supports this contention of fact. Moreover, appellants base their appeal upon a contention of fact which was advanced at the trial level and specifically decided against appellants.

Appellants do not question the right of lessor to change the locks on the leased premises, nor the right of lessors to hold lessees for damages, once it is found that an abandonment has occurred. Since the Referee did find that the lessees had abandoned the premises

(Transcript of Record pp. 50-51) and since such abandonment is a specific breach of the Lease, (*Id.* p. 9) lessors acts in changing locks after such abandonment is not a termination of lessors rights under the lease. Lessees have not shown how such acts could constitute such a termination of rights.

II

MAY LESSORS SEEK DAMAGES FROM THE EVICTED LESSEES?

Appellees have followed the provisions of the lease, and those of Section 3308 of the Civil Code of the State of California, to establish a claim against appellants. Civil Code § 3308 provides:

> "The parties to any lease of real or personal property may agree therein that if such lease shall be terminated by the lessor by reason of any breach thereof by the lessee, the lessor shall thereupon be entitled to recover from the lessee the worth at the time of such termination, of the excess, if any, of the amount of rent and charges equivalent to rent reserved in the lease for the balance of the stated term or any shorter period of time over the then reasonable rental value of the premises for the same period.
>
> "The rights of the lessor under such agreement shall be cumulative to all other rights or remedies now or hereafter given to the lessor by law or by the terms of the lease; provided, however, that the election of the lessor to exercise the remedy hereinabove permitted shall be binding upon him and exclude recourse thereafter to any other remedy for rental or charges equivalent to rental or damages for breach

> of the covenant to pay such rent or charges accruing subsequent to the time of such termination. The parties to such lease may further agree therein that unless the remedy provided by this section is exercised by the lessor within a specified time the right thereto shall be barred." (CAL. CIV. CODE § 3308)

The lease between the parties, at paragraph 21, entitled "DEFAULT", contains the agreement required in the first paragraph of C.C. § 3308. (Transcript of Record pp. 10-11) The lessees were found by the trial court to be in breach, having abandoned the premises (Transcript of Record, pp. 51-52, 68-71).

The second paragraph of Civil Code § 3308 then limits the lessors to an election. The Lessors may have an immediate cause of action for damages, pursuant to the first paragraph of that section, or they may avail themselves of other remedies, but if they sue for damages under the first paragraph of Civil Code § 3308, they lose whatever *other* remedies they may have had. Appellees seek only the damages as provided by the first paragraph of said statute, but appellants contend that, having evicted the lessees, lessors may not then sue for damages — the *eviction* being an election (Brief of Appellants, p. 6). Such a construction completely ignores the remedy afforded by the first paragraph of Civil Code § 3308.

At page 11 of their Brief, Appellants contend: "Appellees as landlords did not give the required notice to appellants." (Brief of Appellants, p. 11) Appellants do not state what is "required" in a notice, but only that lessors' notice was not sufficient to give the appellees the right to relet the premises, to relet the premises for a different rental, or to relet the premises for a term beyond the original term without giving the lessees notice of the lessors' intention to do so.

It may be seen that paragraph 21 of the lease between the parties provides that lessors may have each and every one of the aforementioned rights and may exercise the same without an intention to do so. Still, on August 5, 1966, lessors sent certain letters, one to Mr. Daniel Sullivan, alleged bankrupt, and one to the attorneys for the alleged bankrupts (Transcript of Record, pp. 49-50).

> "In the absence of a contrary provision, reentry by the lessor, without notification to the tenant that he is doing so on the tenant's account, terminates the lease. *This result is avoided by the agreement that reentry shall not be so construed unless written notice of this intention is given to the tenant.* Such a provision is approved in *Brown v. Lane* (1929) 102 Cal.App. 350, 283 P. 78."
>
> (Continuing Education of the Bar, *Legal Aspects of Real Estate Transactions,* 474) (Emphasis added)

It may be seen that the lease provides that reentry shall not be construed as a termination of the lease (Transcript of Record, pp. 10-11).

If the new lessee of the premises should exercise his option, the second five-year term of said new lease would extend approximately two years beyond the original term of the lease at bar; thus, the question: Does a new lease for a potentially longer term terminate lessors' right to recover herein?

> "Appellant's second contention is that the evidence required findings to the effect that the respondent accepted his surrender of the leased premises and terminated the lease by repossessing the premises, making repairs and alterations and reletting them to new tenants *for a period extending beyond the*

expiration date of his lease. The complete lack of merit in this contention is demonstrated by the decisions in *Yates v. Reid,* 36 Cal.2d 383 [224 P.2d 8] and *Narcisi v. Reed,* 107 Cal.App.2d 586 [237 P.2d 558]. Both the last cited decisions recognize the rule that ordinarily a reletting or any act inconsistent with the rights of the tenant under the lease amounts to an election to terminate the existing lease. They hold, however, that the lease may be so drawn as to contain provisions by which the application of that rule is avoided. . . . "

(Wiese v. Steinauer, 201 Cal.App.2d 651, 657) (Emphasis by the court)

Since the lease between the parties also contains a right to alter the premises and to relet them for a period extending beyond the expiration of the original lease (Transcript of Record, pp. 10-11), this argument of appellants must also fail.

SUMMARY

Appellees respectfully submit that the acts of lessors in taking possession of abandoned premises did not constitute a termination of all of their rights under their lease with alleged bankrupts, and, further, that the provisions of Section 3308 of the Civil Code of the State of California afford to lessors their cause of action, and thus their claim, for liquidated damages under the Bankruptcy Act.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

By GEORGE H. ELLIS

George H. Ellis
Attorney for Appellees

No. 22348

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Appellants,

vs.

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Appellees.

ON APPEAL FROM
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REPLY BRIEF OF APPELLANTS

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REPLY BRIEF OF APPELLANTS

ARGUMENT

I

THE APPELLANTS ARE AGGRIEVED PARTIES

The Appellees argue that because Appellants submitted Findings of Fact and Conclusions of Law to conform with the decision of the Referee in Bankruptcy, therefore, they are not "aggrieved" and should not be heard on appeal.

The case law disagrees with appellees' contentions:

Grant v. Board of Medical Examiners (1965), 232 Cal. App. 2d 820 at 827:

> "Generally speaking a party not aggrieved is a party not beneficially interested."

Grief v. Dullea (1944), 66 Cal. App. 2d 986:

> "Parties having no interest in an action are not aggrieved parties, and hence may not appeal."
>
> "The right to appeal should be recognized unless the statute provides otherwise, and it should not be denied upon technical grounds if the appellant is acting in good faith."

Buffington v. Ohmert (7 August 1967), 253 ACA 300:

> "A 'party aggrieved' is one who has an interest recognized by law in the subject matter of the judgment and whose interest is injuriously affected by the judgment."

(Danielson v. Stokes, 214 Cal. App. 2d 234, 237.)

II

THERE IS NO RIGHT OF REENTRY UNTIL A PROPER THREE DAY NOTICE IS SERVED.

The Appellees make much of the point that the lease provides that reentry shall not terminate the lease, and also the provisions of the lease give the lessors multiple rights and remedies to be exercised at any time.

The entire question was discussed by Los Angeles County Superior Court Commissioner, JOHN LESLIE GODDARD, in an article appearing in the Los Angeles Daily Journal on 18 January 1968.

Commissioner Goddard points out that the law on reentry cannot be fixed by the provisions of a lease, and that the landlords do not have a right of forcible reentry, and without proper notices lease provisions are not sufficient.

The leading case and last case on the subject which was discussed by Commissioner Goddard is Jordan v. Talbot (1961), 55 Cal. App. 2d 597, where the California Supreme Court held:

> "It is settled that no immediate right to possession can be obtained under a right of reentry until a proper three day notice has been served on the leassee or grantee."

"Even if the lease had authorized a forcible entry it would be invalid as violating the policy of the forcible entry and detainer statutes."

It is clear then, when the appellees, as lessors, changed the locks and took forcible possession, the lease was terminated; as their action was without the service of a three day notice or any other notice.

Commissioner Goddard points out that the amendments in 1967, to California Civil Code §1860 and 1861a, does not reverse the Jordan V. Talbot case; and in fact if upheld, applies only to apartment houses, cottages, or bungalow courts.

CONCLUSION

The day the appellees, as lessors, took possession, without giving any notices; their claim was for $253.09; therefore, the Referee in Bankruptcy was without authority to adjudicate appellants as bankrupts.

Respectfully submitted,
COURTNEY & COURTNEY
By: /s/ Norman P. Courtney
Attorneys for Appellants

CERTIFICATE

I certify, that in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

/s/ Norman P. Courtney

NORMAN P. COURTNEY

CRIM. NO.

22349

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DOMENIC N. MASTRIPPOLITO,
CLINTON B. HOWARD,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANTS' OPENING BRIEF

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APPELLANTS' OPENING BRIEF

JURISDICTIONAL FACTS

This is a joint appeal by the two named appellants who were indicted on October 12, 1966, in a two count indictment by the Federal Grand Jury in the Central District of California. Each count charged violation of Section 4411 and 4412, Title 26 U.S.C. and wilful evasion of said tax in violation of Section 7201, Title 26 U.S.C. Each appellant was charged as a principal in one count and as an aider and

abettor in the other count.

On January 30, 1966, both appellants were found guilty by the Court, having waived jury trial, and were sentenced to one year on each count, said sentences to run concurrently.

On February 9, 1967, this sentence of appellant HOWARD was modified to a fine of $300.00, which was paid on March 1, 1967.

Appellant MASTRIPPOLITO filed notice of appeal on January 30, 1967, the day sentence was pronounced, and appellant HOWARD filed notice of appeal on February 6, 1967.

STATEMENT OF FACTS

The appellants herein entered into a stipulation by counsel that the evidence was sufficient to establish a violation of Sections 4411 and 4412 of Title 26, United States Code and that the pleadings were in proper form.

ARGUMENT

It is the contention of both appellants that Sections 4411 and 4412 of Title 26, United States Code violates the Fourth Amendment to the Constitution of the United States in as much as said provisions of Title 26 makes it mandatory that persons engaged in accepting wagers on horseracing or sporting events incriminate themselves under the law of the State in which they reside.

On June 15, 1964, the Supreme Court of the United States in Murphy v. Waterfront Commission of New York, 378 U.S. 52, 12 L. ed. 2d 678, 84 S. Ct. 1594, held that the Constitutional privilege against self incrimination protects a state witness against incrimination in a Federal Court where a state has granted a witness immunity against state prosecution.

In the case at bar there was no immunity granted to appellants who were required to buy the tax stamp under the provisions of Sections 4411 and 4412 of Title 26, U.S.C.

However, the question raised by appellants herein does not turn upon the question of whether there was a grant of immunity by either the state or Federal jurisdiction. The Murphy case is significant in that it establishes that the privilege against self incrimination "registers an important advance in the development of our liberty - one of the great landmarks in man's struggle to make himself civilized." Ullman v. United States, 350 U.S. 422, 426, 100 L. ed. 511, 518, 76 S. Ct. 487.

The ultimate question raised by appellants is whether the Federal Government can eliminate the privilege against self-incrimination in a state jurisdiction by the guise of a tax statute that has no realistic relationship to taxable activities except to protect a monopoly created in favor of race track operators in the states in this country.

It must be recognized that accepting wagers on horse

races and sporting events is not a violation of any Federal law. The race tracks in our various states do this openly and with state sanction about every day of each year.

In almost every state the Legislature has seen fit to protect a monopoly it has created by making it a felony for anyone not operating a licensed race track to accept a wager on a horse race.

The critical issue in this case is whether the Federal Government, without granting immunity from state prosecution, can compel citizens of the states to furnish information which would incriminate them under state law as a condition to being engaged in competition with other citizens in their own state who derive their livlihood from the same business.

In other words does the Fifth Amendment to the Constitution of the United States apply to legislative action as well as judicial or executive action.

It is submitted that Sections 4411 and 4412 of Title 26 U.S.C. are unconstitutional and the convictions of appellants should be reversed.

Respectfully submitted

JOHN J. Bradley,
Attorney for Appellants.

CERTIFICATION OF COUNSEL

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: January 12, 1968.

JOHN J. BRADLEY,
Attorney for Appellants.

AFFIDAVIT OF SERVICE BY MAIL

STATE OF CALIFORNIA)
) ss.
COUNTY OF LOS ANGELES)

MARIE LUETCKE, being first duly sworn, deposes and says:

That I am and was at all times herein mentioned a citizen of the United States and employed in the County of Los Angeles, over the age of eighteen years and not a party to the within action or proceeding.

That my business address is Suite 419, 215 West Fifth Street, Los Angeles, California 90013.

That on January 12, 1968, I served the within Appellants' Opening Brief on the Appellee in said action or proceeding by depositing a true copy thereof, enclosed in a sealed envelope with postage fully prepaid, in a mail-box located in the Lobby at 215 West Fifth Street, Los Angeles, California, addressed to the attorneys for the said Appellee at the office address of said attorneys as follows:

WILLIAM MATTHEW BYRNE, JR.
United States Attorney

GERALD F. UELMEN
Assistant United States Attorney

600 U. S. Courthouse

312 North Spring Street

Los Angeles, California 90012

Dated: January 12, 1968.

Marie Luetcke

Subscribed and sworn to
before me this 12th day of
January, 1968.

Lillian Ashley, Notary Public
in and for the County of Los
Angeles, State of California

My Commission Expires: September 3, 1970.

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NO. 22349

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DOMENIC N. MASTRIPPOLITO,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF APPELLEE

I

JURISDICTIONAL STATEMENT

This is an appeal from the conviction of both appellants, each on one count of wilful evasion of the occupational tax (wagering), in violation of Sections 4411 and 7201, Title 26, United States Code, and one count of aiding and abetting, in violation of Section 2, Title 18, United States Code. Jurisdiction of the District Court was based upon Section 3231, Title 18, United States Code. Jurisdiction of this Court to entertain the appeal by appellant Mastrippolito is derived from Sections 1291 and 1294, Title 28, United States Code. The appellee contends, however, that this Court has no

jurisdiction to entertain the appeal by appellant Howard, and hereby moves that said appeal be dismissed on the ground it is moot.

II

SPECIFICATION OF ERRORS

The following issue is raised by the motion of the Appellee to dismiss the appeal by appellant Howard:

(1) Does this Court have jurisdiction to entertain an appeal from a criminal conviction where the only sentence imposed, a fine, has been paid in full without securing a stay of execution?

Only one issue is raised by the argument presented in Appellant's Opening Brief, in light of the recent decision of the Supreme Court in Marchetti v. United States, ___ U.S. ___, 36 L.W.4143 (Jan. 29, 1968):

(2) Does Marchetti v. United States require reversal of the conviction of appellant Mastrippolito?

III

STATEMENT OF FACTS

The following statement of facts has been stipulated to as an agreed statement on appeal, pursuant to Rule 76, Federal Rules of Civil Procedure:

On October 12, 1966, the Federal Grand Jury sitting for the Central District of California returned a two count indictment

charging in Count One that appellant Domenic N. Mastrippolito, during the tax year ending June 30, 1967, was engaged in the business of accepting wagers and engaged in receiving wagers for others engaged in such business, was required by law to pay the Occupational Tax (Wagering) imposed by Sections 4411 and 4412, Title 26, United States Code, and that he wilfully attempted to evade and defeat said tax in violation of Title 26, United States Code, Section 7201. The same charge was made in Count Two as to appellant Howard, who was also charged with aiding and abetting Mastrippolito in Count One. Similarly, appellant Mastrippolito was charged with aiding and abetting Howard in Count Two.

On November 7, 1966, both appellants appeared and entered pleas of not guilty.

On January 4, 1967, trial began before the Honorable Jesse W. Curtis, United States District Judge. Trial by jury was waived. A Motion to Suppress, filed on behalf of appellant Howard, was denied after full hearing.

By Stipulation (Exhibit #19), it was agreed that Clinton B. Howard did not register or pay for the Special Occupational Tax Stamp, Wagering, for the tax year ending June 30, 1967, and that Domenic N. Mastrippolito did not register or purchase said Tax Stamp until October 4, 1966, three days after appellant Howard's arrest.

Testimony revealed that investigation of this case began on September 19, 1966, when agents of the Intelligence Division of the Internal Revenue Service were told by a reliable, confidential

informant that the appellant Domenic Mastrippolito was currently operating as a bookmaker in the Los Angeles area, and was accepting wagers over telephone number PO 9-4494. A representative of Pacific Telephone Company identified this as an unlisted number subscribed to by Penelope Spencer at 3871 Willowcrest Avenue, Apartment 11, North Hollywood, California.

Working undercover, Special Agent Werner Michel of the Internal Revenue Service rented Apartment 10 at 3871 Willowcrest Avenue, North Hollywood, for the purpose of identifying the occupant of Apartment 11. On September 29, 1966, while in Apartment 10, Agent Michel was approached by appellant Clinton B. Howard, who knocked on the door, identified himself, and told Michel that he resided in Apartment 11, and that he would be home during the day and hoped that the noise would not bother Mr. Michel. In parting, he asked Michel, "You're not a bookmaker, are you?". Agent Michel observed Howard return to Apartment 11, and later leave from that apartment.

The same day, agents learned that a new telephone number was being used by appellant Mastrippolito to accept wagers. This number, TR 2-0101, was identified as an unlisted number subscribed to by C. B. Howard at 4547 Colbath, Apartment 12-A, Sherman Oaks, California. In surveillance, agents observed the appellant Howard leave the apartment at 4547 Colbath at 6:40 p.m., and drive to the apartment at 3871 Willowcrest Avenue. The next morning, Howard's automobile was observed parked at 4547 Colbath Avenue.

On September 30, 1966, search warrants were issued for 4547 Colbath Avenue, Apartment 12-A, as well as 3871 Willowcrest Avenue, Apartment 11, by the United States Commissioner at Los Angeles. Both warrants were executed the following day. The search of 3871 Willowcrest, Apartment 11, revealed that the apartment was empty except for two telephones, which had been disconnected and placed in the bottom drawer of a cupboard. At approximately 1:20 p.m., after knocking, announcing their authority and purpose, then waiting 30 seconds, agents forced entry to apartment 12-A at 4547 Colbath Avenue. Upon entering, the agents observed appellant Clinton Howard seated at a desk, wiping a slate (Exhibit No. 1), with a damp rag (Exhibit No. 2). After Mr. Howard was placed under arrest, a search of the desk at which he was seated revealed a typical bookmaker's "phone spot", where bets are initially called in by the bettors and temporarily recorded until relayed to a "back office" where permanent records are kept. Expert testimony elicited at trial revealed that the reason permanent records are not kept at a "phone spot" is because that is the number known to the bettors, hence the most susceptible to "visits" by law enforcement officers. A slate and a damp rag is a device frequently used to destroy records of bets, which are written on the slate with felt pens (several felt pens were also seized, Exhibit No. 5). Also seized were numerous Sports Journals, listing games to be played, with written notations of the "line" or abetting odds (Exhibits Nos. 4, 7). "Line" information and other notations were also recorded on rice paper, a type of paper which immediately

dissolves upon contact with water (Exhibits Nos. 6, 9).

In a bedroom dresser drawer, agents found a set of handwritten instructions, detailing the steps to be taken by a phone spot clerk to destroy the evidence in the event of a raid by law enforcement officers (Exhibit No. 13).

Other items found in the apartment included listings of bettors, bearing a reference to "Dom" (Exhibit No. 8), a diary containing newspaper clippings relating to the arrest of Domenic Mastrippolito and others on charges of evading the Federal Occupational Tax Stamp (Wagering) (Exhibit No. 10), and an address book listing bettors and "code numbers" used for identification (Exhibit No. 11).

While searching the premises, the agents answered the telephone on numerous occasions. One caller asked "where's Dom?" Some callers merely left a name or a code number, others asked for odds, and still others actually placed bets with the agents. These bets were on football games at 11 for 10. Testifying as an expert, a special agent of the Internal Revenue Service explained that a bookmaker's profit on sports bets is derived from "vigorish", or the extra 10% that a bettor pays on a bet. To win $100, a bettor must put up $110. Ideally, a bookmaker "balances" his books, having an equal amount of bets on both teams. Therefore, regardless of which team wins, he will turn a profit, collecting more in losses than he pays out in winnings.

On October 4, 1966, the United States Commissioner at Los Angeles, California, issued an arrest warrant for appellant

Domenic Mastrippolito. Pursuant to this warrant, the appellant Mastrippolito was arrested while leaving his automobile on October 10, 1966. A search of his person revealed a sports journal used to record changes in "line" information or odds (Exhibit No. 14). In his automobile, cash in the amount of $9,643.00 was found under the front seat. After being advised of his rights, Mr. Mastrippolito, referring to the arresting agent, asked another agent, "Am I the only bookmaker he knows?".

Numerous bettors were located through the records seized and phone calls received at the apartment occupied by appellant Howard. At trial, Morton Kendall testified that appellant Mastrippolito assigned him a code number and told him he could place bets over telephone No. PO 9-4494, the number listed to Apartment 11, 3871 Willowcrest Avenue, North Hollywood, California. He was also given telephone No. TR -20101, the number listed to appellant Howard at the apartment where he was arrested. Kendall testified he placed several sports wagers over each of these numbers during the week ending October 1, 1966. These wagers were at bookmaker's odds, and Kendall testified he left the money to pay his losses with his secretary, instructing her to give the money to appellant Mastrippolito.

Kermit Baumoel testified that appellant Mastrippolito gave him telephone numbers TR 7-7880 and 981-1234 for the purpose of placing wagers. By stipulation it was admitted that TR 7-7780, with PO 9-4494, was listed to Penelope Spencer at the Willowcrest address, while 981-1234, with TR 2-0101, was listed to appellant

Howard at the apartment where he was arrested (Exhibit No. 19). Baumoel admitted placing several sports wagers over these numbers during the period July - October, 1966, and that he settled his wins and losses directly with appellant Mastrippolito.

By Stipulation (Exhibit No. 21), Dean Martin testified that during the period July - October, 1966, he placed several sports wagers at bookmaker's odds, both in person to appellant Mastrippolito and by calling TR 7-7780. Payment of losses was made directly to Mr. Mastrippolito.

Also by stipulation, Dr. Kay Toma testified that on numerous occasions he called TR 2-0101 for the purpose of placing wagers with appellant Howard, the most recent occasion being September, 1966.

After offering in evidence certified copies of four prior convictions of appellant Mastrippolito for the same offense, which offer was rejected as "unnecessary", the Government rested. Neither appellant presented a defense.

The trial court found both defendants guilty of both counts of the indictment.

On January 30, 1967, appellant Howard's motion for a new trial, joined by appellant Mastrippolito, was denied. Both appellants were sentenced to one year imprisonment on each count, the sentences to run concurrently.

On February 9, 1967, Judge Curtis entered an Order modifying sentence, providing that in lieu of the sentence imposed January 30, 1966, appellant Howard pay a fine of $300.

On March 1, 1967, the judgment as to appellant Howard was satisfied by payment of the fine in full.

This appeal then followed.

IV

ARGUMENT

A. THIS COURT DOES NOT HAVE JURISDICTION TO ENTERTAIN AN APPEAL FROM A CRIMINAL CONVICTION WHERE THE ONLY SENTENCE IMPOSED, A FINE, HAS BEEN PAID IN FULL WITHOUT SECURING A STAY OF EXECUTION.

As stipulated, appellant Howard was originally sentenced on January 30, 1967, to one year on each count, the sentences to run concurrently. His notice of appeal was filed on February 6, 1967. On February 9, 1967, Judge Curtis entered an order modifying sentence, providing that in lieu of the sentence imposed January 30, 1966, the appellant pay a fine of $300. On March 1, 1967, the fine was paid in full. It is the appellee's contention that payment of the fine rendered this appeal moot as to appellant Howard.

Rule 38(a)(3) of the Federal Rules of Criminal Procedure provides that a sentence to pay a fine may be stayed by the District Court or by the Court of Appeals upon such terms as the court deems proper. Here, however, no effort was made to stay execution of the sentence.

This Court has twice before been presented with an identical situation. In Gillen v. United States, 199 F.2d 454

(9th Cir. 1952), this Court dismissed as moot an appeal from a criminal conviction in which the fine imposed had been paid, citing Hanback v. District of Columbia, 35 A.2d 189 (D.C. Mun. App.). More recently, in Penneywell v. McCarrey, 255 F. 2d 735 (9th Cir. 1958), an appeal was dismissed as moot because a fine had been paid, even though the ordinance under which the appellant had been convicted was subsequently declared invalid, and the fact that the fine had been paid was unknown to appellant's attorney. Accord: Government of Virgin Islands v. Ferrer, 275 F. 2d 497 (3rd Cir. 1960); Bergdoll v. United States, 279 Fed. 404 (3rd Cir. 1922), cert. denied 259 U.S. 585.

The situation presented here is analogous to that of a prisoner who has served his sentence of imprisonment in full prior to the determination of his appeal. The appeal is rendered moot. St. Pierre v. United States, 319 U.S. 41 (1943); Williams v. United States, 261 F. 2d 224 (9th Cir. 1958), cert. denied 358 U.S. 942.

As stated by the Supreme Court in St. Pierre v. United States, supra, at p. 43: "The moral stigma of a judgment which no longer affects legal rights does not present a case or controversy for appellate review." Cf. City of Seldovia v. Lund, 138 F. Supp. 382 (D. Alaska 1956).

B. MARCHETTI v. UNITED STATES DOES NOT REQUIRE REVERSAL OF THE CONVICTION OF APPELLANT MASTRIPPOLITO.

On January 29, 1968, the United States Supreme Court handed down its long awaited opinion in the case of Marchetti v. United States, ___ U.S. ___, 36 L.W. 4143. Marchetti was an appeal from convictions of both failure to pay the occupational tax imposed by Section 4411, Title 26, United States Code, and the accompanying registration provision, Title 26, United States Code, Section 4412. 1/ The Supreme Court had granted certiorari to re-examine the constitutionality under the Fifth Amendment of the wagering tax statutes. 385 U.S. 1000. In reversing Marchetti's conviction, the Supreme Court held:

> "that petitioner properly asserted the privilege against self-incrimination, and that his assertion should have provided a complete defense to this prosecution. . . . We emphasize that we do not hold that these wagering tax provisions are as such constitutionally impermissible; we hold only that those who properly assert the constitutional privilege as to these provisions may not be criminally punished for failure to comply with their requirements."

1/ The appellants here were convicted only of evading, and aiding and abetting the evasion of, the occupational tax. They were not convicted of failure to register under Section 4412 as asserted in Appellants' Opening Brief, pp. 1, 2.

Slip Opinion at p. 21; 36 L. W. at 4149-50. (Emphasis added).

It is submitted that the conviction of appellant Mastrippolito differs in two significant respects from the Marchetti case, each of which requires a result different than that in Marchetti. First, neither appellant at any time asserted his constitutional privilege in the proceedings below. Secondly, and most important, both appellants stand convicted of the crime of aiding and abetting each other.

In the Marchetti opinion, the Supreme Court went to great pains to emphasize that self-incrimination was a defense to a criminal prosecution. For example:

> "We have concluded that these provisions may not be employed to punish criminally those persons who have defended a failure to comply with their requirements with a proper assertion of the privilege against self-incrimination." Slip Opinion at p. 2, 36 L. W. at 4144. (Emphasis added).

> "It would appear that petitioner's assertion of the privilege as a defense to this prosecution was entirely proper, and accordingly should have sufficed to prevent his conviction." Slip Opinion at p. 10, 36 L. W. at 4146. (Emphasis added).

"We conclude that nothing in the Court's opinions in Kahriger and Lewis now suffices to preclude petitioner's assertion of the constitutional privilege as a defense to the indictments under which he was convicted." Slip Opinion at p. 15, 36 L. W. at 4148. (Emphasis added).

"We emphasize that we do not hold that these wagering tax provisions are as such constitutionally impermissible; we hold only that those who properly assert the constitutional privilege as to these provisions may not be criminally punished for failure to comply with their requirements." Slip Opinion at p. 21, 36 L. W. at 4149-50.

Here, unlike Marchetti, the appellants at no time during the course of proceedings in the Court below asserted their privilege against self-incrimination as a defense. The question was first raised on appeal to this Court. It has repeatedly been held that a defense may not be raised for the first time on appeal. Cellino v. United States, 276 F. 2d 941, 947 (9th Cir. 1960); Ramirez v. United States, 294 F. 2d 277 (9th Cir. 1961); Hedgepeth v. United States, 365 F. 2d 952 (D. C. Cir. 1966); United States v. Bishop, 367 F. 2d 806 (2nd Cir. 1966).

The second and most significant respect in which the conviction of appellants differs from Marchetti is that both stand

convicted of aiding and abetting each other in violation of Section 2, Title 18, United States Code.

Aiding and abetting is a separate offense, of which one can be convicted even though he is incapable of himself committing the substantive crime of which he is accused of aiding and abetting. United States v. Melekh, 193 F. Supp. 586, 592 (N.D. Ill. 1961); Haggerty v. United States, 5 F.2d 224 (7th Cir. 1925).

Clearly, one who is accused of aiding and abetting another to evade the wagering tax could not defend by asserting the Fifth Amendment privilege of the person he was assisting. The privilege against self-incrimination "is purely a personal privilege". Hale v. Henkel, 201 U.S. 43, 69 (1906); Rogers v. United States, 340 U.S. 367, 371 (1951). Thus, a defendant cannot assert the privilege on behalf of a witness called to testify against him. Bowman v. United States, 350 F.2d 913 (9th Cir. 1965), cert. denied 383 U.S. 950; Long v. United States, 360 F.2d 829, 834 (D.C. Cir. 1966). Similarly, one defendant cannot assert the privilege on behalf of a co-defendant. This was implicitly recognized by the Supreme Court in Communist Party v. Subversive Activities Control Board, 367 U.S. 1 (1961). In upholding the Board classification of the Party as a "communist action" organization required to register, the claim that the registration requirement would compel party officers to incriminate themselves was rejected as premature, since only the officers themselves could invoke their privilege:

> "The privilege against self-incrimination is one which normally must be claimed by the individual who seeks

to avail himself of its protection." 367 U.S. at 107. When the privilege was properly asserted, it was subsequently upheld. Albertson v. Subversive Activities Control Board, 382 U.S. 70 (1965).

As noted above, neither appellant asserted his Fifth Amendment privilege on his own behalf at trial. Even if appellant Mastrippolito were allowed to assert his privilege for the first time on appeal, it would serve only to bar his conviction for himself having evaded the tax. Since a defendant has "no right to insist that other guilty persons stand on their rights", Poole v. United States, 329 F.2d 720, 721 (9th Cir. 1964), his conviction for aiding and abetting remains intact, falling within the class of cases the Supreme Court had in mind when it concluded Marchetti by stating:

> "If, in different circumstances, a taxpayer is not confronted by substantial hazards of self-incrimination, or if he is otherwise outside the privilege's protection, nothing we decide today would shield him from the various penalties prescribed by the wagering tax statutes." Slip Opinion at p. 21, 36 L.W. at 4150.

CONCLUSION

The appeal of appellant Howard being moot, the appellee respectfully prays that it be dismissed. The Government further submits that the holding of the Supreme Court in Marchetti v. United States does not require reversal of the conviction of appellant Mastrippolito.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Gerald F. Uelmen
GERALD F. UELMEN

No. 22352

IN THE

United States Court of Appeals

For the Ninth Circuit

PETER PAN SEAFOODS, INC., a Washington corporation,
Appellant,

v.

THE UNITED STATES OF AMERICA,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE GEORGE H. BOLDT,
United States District Judge

OPENING BRIEF OF APPELLANT

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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE GEORGE H. BOLDT,
United States District Judge

OPENING BRIEF OF APPELLANT

STATEMENT OF JURISDICTION

This is a civil action by appellant, Peter Pan Seafoods, Inc., a Washington corporation, against the appellee, The United States of America, to recover income taxes and interest in the total amount of $286,886.26, erroneously assessed and collected for appellant's taxable years ended March 31, 1960, and March 31, 1961 (R. 1-77, 109, 125). Appellant's Complaint was filed in the United States District Court for the Western District of Washington, Southern Division, on February 17, 1965 (R. 1). That

court had jurisdiction of the action under and by virtue of 28 U.S.C.A. Section 1346(a)(1).

Following trial of the case before the Honorable George H. Boldt, sitting without a jury, a Judgment of dismissal was entered on August 7, 1967 (R. 128) from which appellant appealed to this court on October 4, 1967 (R. 129). This court has jurisdiction to review the Judgment in question under and by virtue of 28 U.S.C.A. Sections 1291 and 1294(1).

STATEMENT OF THE CASE

The Questions Involved

This is an action by appellant, Peter Pan Seafoods, Inc., hereinafter referred to as appellant taxpayer, to recover income taxes and interest in the total amount of $286,886.26, assessed and collected by the Commissioner of Internal Revenue for the taxable years ended March 31, 1960, and March 31, 1961, as a result of the recomputation by the Commissioner of net operating losses carried forward from prior years. The transactions upon which the Commissioner bases his recomputation of said net operating losses occurred in the tax year ended March 31, 1957 and involved the acquisition by another Washington corporation, The Ajax Company, of two mortgage notes previously executed and issued by appellant taxpayer.

It was the initial contention of appellee that these two mortgage notes were in substance acquired by appellant taxpayer, which thereby realized income as the result of cancellation of indebtedness. During the trial in the court below, appellee put forth a further contention based on

Section 269(a) of the Internal Revenue Code of 1954.[1]

The transactions in question may be briefly summarized as follows:

In 1950, appellant taxpayer executed two mortgage notes in the total amount of $1,668,432. Six years later, in 1956, it appeared that these mortgage notes might be purchased at a substantial discount. However, it was determined by the president of appellant taxpayer, Mr. Nick Bez, that it was not feasible for appellant taxpayer to attempt to acquire them, because, in his opinion, the income tax liability which would be incurred as a result of the acquisition, when added to any possible purchase price, would result in an overall cost for the notes which would be prohibitive under the circumstances as they then existed (Admitted Facts X, XIII, XIV, R., 86-88, 125).

Mr. Bez, who was also a substantial stockholder of appellant taxpayer, then began to explore the possibility of joining with other stockholders to purchase the notes. To this end, he caused The Ajax Company to be organized and solicited other stockholders of appellant tax-

(1) Sec. 269(a) of the Int. Rev. Code of 1954 (prior to 1963 amendment), insofar as claimed by appellee to be applicable, provides as follows:

"(a) In General. —If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) * * *

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 per cent of the total combined voting power of all classes of stock entitled to vote or at least 50 per cent of the total value of shares of all classes of stock of the corporation."

payer for subscriptions for stock and notes to be issued by The Ajax Company (Admitted Facts XV, XVI, R. 88, 89, 125).

The larger number, but not all, of the stockholders of appellant taxpayer subscribed for Ajax stock and notes, and with the funds so obtained and the proceeds of a bank loan, The Ajax Company negotiated for and acquired the mortgage notes for an aggregate net purchase price of $774,228.00. Simultaneously with their acquisition, the mortgage notes were pledged by The Ajax Company to the bank as collateral for its bank loan. After the acquisition of the mortgage notes, payments of interest and principal thereon were made by appellant taxpayer to The Ajax Company. From the date of incorporation of The Ajax Company until it acquired all of the stock of appellant taxpayer in 1959, The Ajax Company did not engage in any business activity other than the acquisition of said mortgage notes and the negotiations in connection therewith, and during said period, said mortgage notes were its only assets, except for a small amount of cash (Admitted Facts XVII thru XXXII, and XL, with related Exhibits, R. 89-95, 99).

It has been stipulated by the parties that the income tax liability of the appellant taxpayer for its taxable years ended March 31, 1960 and March 31, 1961 is correctly stated in the Commissioner's Notice of Deficiency (Ex. A-1), except insofar as the same may be affected by the court's decision on the issue of law herein[2] (Stipulation IV, R. 104).

(2) Net operating loss carrybacks from later years are also excepted since the Government concedes that a decision in this case should not bar taxpayer from the benefit of carrybacks which may develop after the Commissioner's Notice of Deficiency.

The issue of law in this proceeding is stated in the Pre-Trial Order as follows:

> "The following is the issue of law to be determined by the Court: Whether or not, as a result of the transactions involved with reference to the said mortgage notes, Plaintiff [Appellant Taxpayer] realized taxable income in its taxable year ended March 31, 1957 from cancellation of indebtedness." (R. 104).

At the close of the case before the court below (but before argument), the Government put forth the further contention above mentioned based on Section 269(a)(1) of the Internal Revenue Code. This contention was asserted in a trial brief which was the first notice of it that appellant taxpayer received except for mention of it in a telephone conversation on the eve of trial (Transcript of Proceedings of February 10, 1967, pp. 37, 42).

The court below found as a fact that the primary, dominant and moving purpose for the formation of The Ajax Company was to avoid Federal income tax on the purchase of the mortgage notes (Finding of Fact No. 10, R. 127). On the basis of this finding, the court concluded that the negotiations for, and purchase and holding of, the mortgage notes (which was stipulated to be the only business activity of Ajax until it acquired all of the stock of appellant taxpayer in 1959) did not constitute a business for the purpose of applying the tax statutes because "escaping taxation is not 'business'", and consequently cannot be said to have any commercial or industrial purpose (R. 117).

The conclusions of law of the court below were that

1. The mortgage notes in question were in substance purchased by appellant taxpayer and should be so treated for purposes of determining Federal income tax liability

and that, accordingly, appellant taxpayer realized taxable income under Section 61(a)(12) of the Internal Revenue Code of 1954 upon the purchase of the notes at a discount; and

2. The net operating loss deductions claimed by appellant taxpayer are disallowed by Section 269(a) of the Code (R. 127).

It is the contention of appellant taxpayer that—

1. Appellant taxpayer was not under any legal or other compulsion to purchase its mortgage notes, and avoidance of the ruinous tax consequences of doing so was a legitimate reason for not purchasing them.

2. The stockholders of appellant taxpayer, or any group of them, had every right to purchase the notes for their own account, if the holders were willing to sell; and such stockholders had every right to organize and employ a separate corporation as the vehicle to accomplish such purchase. The Admitted Facts establish that this was what was done.

3. The motive of tax avoidance will not establish tax liability if the transaction does not do so without it.

4. The purchase of an indebtedness by the stockholders of the debtor corporation, or by a new corporation organized by such stockholders for that purpose, does not constitute an acquisition of the indebtedness by the debtor; and the motive of tax avoidance will not convert the transaction into a purchase of the indebtedness by the debtor corporation, in substance or otherwise.

5. Negotiations for and purchase of mortgage notes at a discount from unrelated third parties is a legitimate business activity with a clear commercial purpose, who-

ever the purchaser may be, and the motive of tax avoidance does not change its character in that respect; thus, the fact that the appellant taxpayer could have purchased the mortgage notes does not render the purchase by Ajax devoid of a commercial purpose, whatever tax avoidance motives may have been involved.

6. Any disregard of the corporate entity of Ajax leads only to its stockholders, not to appellant taxpayer.

7. Section 269(a)(1) cannot apply to the situation here involved because appellant taxpayer did not acquire control of Ajax, nor did Ajax acquire control of appellant taxpayer. The acquisition of such control is essential to the application of this section; and the fact that two corporations have the same, or largely the same, stockholders does not constitute control by one of them over the other within the meaning of this section.

8. Section 269(a)(1) cannot apply to the situation here involved for the additional and independent reason that appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed. On the contrary, the net operating loss deduction which respondent seeks to disallow is a deduction the benefit of which appellant taxpayer *would* otherwise have enjoyed.

Statement of Facts

As stated by the court below, the facts are largely admitted by both parties in the Pre-Trial Order (R. 112).

Appellant taxpayer is a Washington corporation engaged in the business of canning salmon in Alaska and dealing in domestic and foreign canned salmon packed by others (Admitted Fact XXXIV, R. 96).

On March 23, 1950, appellant taxpayer (the name of which was then P. E. Harris Company, Inc.) executed two mortgage notes in the total amount of $1,668,432 for the purchase of certain properties from P. E. Harris & Co., a corporation then in the process of liquidation (Admitted Fact X, R. 86).

Nothwithstanding the similarity of the names of the two corporations, there was no connection between their stockholders, except that two individuals were minor stockholders of both corporations (Admitted Fact XI, R. 86, 87).

In June, 1950, these mortgage notes were transferred by the payee to Seattle-First National Bank as Trustee for the former stockholders of the payee corporation; and said bank issued Certificates of Beneficial Interest to each of such former stockholders to evidence his interest under the trust. There were 68 beneficiaries under this trust, holding a total of 119,112 beneficial interests in all (Admitted Fact XII, R. 87; Ex. A-2).

Six years later, in 1956, it appeared that the mortgage notes might be acquired for an amount substantially less than the balance of the indebtedness evidenced thereby. In view of the possibility of acquiring the mortgage notes, Mr. Nick Bez, the president of appellant taxpayer, inquired of its legal and accounting advisors as to the Federal income tax consequences in the event appellant taxpayer were to acquire the notes. He was advised that any acquisition of said mortgage notes by appellant taxpayer at a substantial discount would result in the realization of taxable income in an amount equal to the discount. On the basis of this advice, Mr. Bez concluded that it

would not be feasible for appellant taxpayer to attempt to acquire the mortgage notes because, in his opinion, the immediate income tax liability which would be incurred as a result of the acquisition, when added to any possible purchase price, would result in an overall cost for the notes which would be prohibitive under the circumstances as they then existed (Admitted Facts XIII, XIV, R. 87, 88).

Mr. Bez, who was also a substantial stockholder of appellant taxpayer, then began to explore the possibility of joining with other stockholders of appellant taxpayer for the purpose of attempting to purchase the mortgage notes. At this time, appellant taxpayer had outstanding 15,000 shares of stock and $700,000 in unsecured notes.[3] It had 27[4] stockholders residing in the states of Washington, California, Florida and other states. Ten of these stockholders held no notes. Three note holders held no stock. Mr. Bez, together with a corporation and a partnership[5] which he controlled owned approximately 25% of appellant taxpayer's stock and approximately 28% of

(3) These unsecured notes had initially been sold pro rata to purchasers of Appellant Taxpayer's stock in 1950, but, as a result of subsequent transfers of stock without notes, and of notes without stock, they were held during the period here involved, as shown by Exhibit SS.

(4) Rather than 29, as indicated by Exhibits S and SS, since the shares registered in the joint names of Calvert Corporation and Trans-Pacific Fishing & Packing Co. were owned by the partnership Peninsula Packers. See note (5). Also, John Earle Jardine and J. E. Jardine, deceased, were the same person.

(5) Trans-Pacific Fishing & Packing Co., a corporation, and Peninsula Packers, a partnership. The sole partners of the partnership Peninsula Packers were two corporations, Trans-Pacific Fishing & Packing Co., the stock of which was owned by Mr. Bez and his family, and Calvert Corporation, the stock of which was owned by members of the Calvert family who had been closely associated with Mr. Bez over a substantial period in various business enterprises relating to the salmon canning and fishing industry in Alaska and the Pacific Northwest (Admitted Fact XXXIII, R. 95, 96).

its unsecured notes, and thus controlled the largest single amount of appellant taxpayer's stock. However, no individual or group held clear control of appellant taxpayer (Admitted Facts XV, XXXII, XXXIII, R. 95, 96; Finding of Fact No. 6, R. 125; Exs. S, SS).

With the assistance of Mr. G. Hamilton Beasley (since deceased), who was also a stockholder, officer and director of appellant taxpayer, Mr. Bez caused The Ajax Company to be organized as a Washington corporation on May 21, 1956 for the purpose of attempting to purchase the mortgage notes. Thereafter, he and Beasley solicited powers of attorney from the other stockholders of appellant taxpayer to subscribe for shares of stock and five-year 6% notes of The Ajax Company. Twenty-two subscriptions for stock and notes of The Ajax Company were thus obtained for a total of 12,928 shares of stock and $129,300.52 in notes (Admitted Facts XVI, XXVII, R. 88, 93; Exs. B, C, R).

No stockholder influential in appellant taxpayer, either by virtue of an executive office or because of substantial stock ownership, declined to participate in the formation of Ajax; however, there were 17 stockholders of appellant taxpayer holding a total of 3,757.40 shares of appellant taxpayer's stock who did not subscribe for any stock or notes of Ajax. Nine of the subscribers for Ajax stock and notes owned no stock of appellant taxpayer. Two of these nine were holders of unsecured notes of appellant taxpayer, and the remaining seven held no stock or notes of appellant taxpayer (Finding of Fact No. 6, R. 125; Ex. SS).

Mr. G. Hamilton Beasley, the president of Ajax, was

the largest single stockholder of appellant taxpayer, owning 2,856 shares. However, he subscribed for only 618 shares of Ajax (Finding of Fact No. 6, R. 126, Ex. SS).

Certain of the stockholders of each corporation who owned no stock in the other corporation were related in one way or another. Thus, Donald Royce (161 shares of appellant taxpayer) was a partner in William R. Staats Company (1,393 shares of Ajax), [Deposition of Wm. A. Hinckley, 12/7/66, p. 6]. Mr. Royce's wife, Mrs. Laura C. Royce, owned 200 shares of appellant taxpayer. Thos. J. Bannan (706 shares of Ajax) was the principal stockholder of Webster-Brinkley Company (706.40 shares of appellant taxpayer) [Tr. 121-125]. The Elizabeth C. Tuerk Trust held $20,590 in appellant taxpayers' unsecured notes and Fred R. and George E. O. Tuerk and various trusts for Tuerk relatives (including the Elizabeth C. Tuerk Trust) subscribed for a total of 1,957 shares of Ajax. None of the Tuerks or Tuerk Trusts held any stock of appellant taxpayer. W. A. Hinckley (44 shares of Ajax), Ned Lewis (177 shares of Ajax), and R. B. Mattson and H. A. Magnuson (89 shares each of Ajax) were business associates of Brayton Wilbur (797 shares of appellant taxpayer and 177 shares of Ajax), and it appears that some of the shares of appellant taxpayer's stock registered in the name of Brayton Wilbur were beneficially owned by his business associates above named [Deposition of Wm. A. Hinckley, 12/7/66, pp. 5, 6, 13-16 and Ex. A thereto; Deposition of Herbert Magnuson, 1/11/67, pp. 5, 6] (Exs. R, S, SS).

Exhibit D is a copy of the subscription for Ajax stock and notes executed by Thos. J. Bannan and is typical of the subscriptions executed by the other 21 subscribers

(Admitted Fact XVI, R. 88, 89).

During January, 1957, negotiations and discussions were held between Mr. Bez, who was again assisted by Mr. Beasley, and Seattle-First National Bank, which held the mortgage notes in trust as above stated, and also with various individuals representing, or purporting to represent, various groups of holders of beneficial interests under said trust. These negotiations established that the Trustee Bank was unwilling to take the responsibility of selling the mortgage notes, and that the only feasible manner in which the notes could be acquired would be by purchasing the beneficial interests under said trust directly from the various holders of said beneficial interests. Mr. Beasley was advised by said bank that if all of the beneficial interests could be acquired, the trust could then be dissolved and said mortgage notes transferred to the purchaser of said beneficial interests as an incident of the dissolution of the trust (Admitted Fact XVII, R. 89).

Mr. Bez also approached Seattle-First National Bank with the view of obtaining a bank loan to Ajax to finance the balance of the purchase price. Seattle-First refused to make such a loan. He then approached The Bank of California. The Bank of California agreed to make the loan but conditioned it on a promise by Bez that in the event Ajax purchased the mortgage notes, appellant taxpayer would make a substantial payment to Ajax on the indebtedness in the near future so that the bank loan could be substantially reduced (Tr. 27-29, 92-97; Finding of Fact No. 8, R. 126).

A special meeting of the Board of Directors of The Ajax Company was held on January 30, 1957, at which

the president, Mr. Beasley, reported on the situation and recommended that an offer be made by Ajax to purchase the beneficial interests. He reported that he had in his possession subscriptions for an additional 9,693 shares of stock and for stockholder loans in the amount of approximately $129,000 which, together with the subscriptions for 3,235 shares already accepted and called for payment, would provide funds in the amount of $142,000; that arrangements had been made with The Bank of California, N.A. to borrow the balance of the funds necessary to complete the purchase, should the company's offer be accepted; and that this bank loan would be secured by pledging the mortgage notes to the bank (Admitted Fact XVIII, R. 89).

The Board then adopted a resolution providing that an offer be made to the beneficial interest holders at a price of $6.50 per beneficial interest; that The Bank of California, N.A. be appointed escrow agent under the offer, and that the sum of $25,000 earnest money be deposited with said bank; that in the event the offer was accepted, the corporation borrow $650,000 from the bank to provide the necessary additional funds to complete the purchase; that in the event the offer was accepted, all necessary steps be immediately taken to bring about the dissolution of the trust, the distribution of the mortgage notes to the company, and the pledge thereof to the bank; and that a special meeting of the Board be called for February 21, 1957 to take such action as might be appropriate as a result of the response of the beneficial interest holders to the offer. Exhibit B is a copy of the Minutes of said meeting (Admitted Fact XVIII, R. 89).

In accordance with the Board's action, a formal offer, dated February 1, 1957, in the form approved by the Board, was forwarded to each of the 68 beneficiaries under said trust together with a "Letter of Deposit Under Offer of the Ajax Company" and an "Assignment of Beneficial Interest Under Trust" to be executed and forwarded to the escrow bank by beneficial interest holders accepting the offer. Said offer, by its terms, extended until February 21, 1957. A copy of said offer, and of the enclosures above mentioned which accompanied it, are attached to and made a part of the Minutes of said meeting, Exhibit B (Admitted Fact XIX, R. 89, 90).

Also pursuant to the Board's action, arrangements were made with The Bank of California, N.A., to act as escrow agent under said offer, and escrow instructions were prepared and forwarded to said bank, together with the sum of $25,000 as the earnest money specified in said offer. Exhibit E is a copy of said escrow instructions, endorsed as accepted by said bank (Admitted Fact XX, R. 90).

As previously arranged, the Board of Directors of Ajax again met on February 21, 1957, and the President reported that he had been advised by the bank that all of the beneficiaries under the trust had accepted the company's offer and had deposited their Certificates of Deposit in escrow with the bank, together with the necessary Letters of Deposit and assignments, and that the purchase of the beneficial interests as contemplated by the offer had been consummated. The Board then adopted a resolution that the corporation proceed to complete the bank loan from The Bank of California as contemplated and authorized at the last meeting, and do all acts and things necessary or appropriate to complete the

purchase and the financing thereof. The additional subscriptions for stock and notes, above mentioned, were then accepted and called for payment. Exhibit C is a copy of the Minutes of said meeting (Admitted Fact XXI, R. 90).

Immediately following this meeting, all necessary steps were taken by the President and Secretary of Ajax to consummate the purchase of said beneficial interests in accordance with the offer and the resolutions of the Board of Directors above mentioned. Exhibit F is a copy of the communication from The Ajax Company to the escrow bank, authorizing consummation of the purchase (Admitted Fact XXII, R. 90, 91).

Upon the consummation of the purchase of the beneficial interests as above stated, the Certificates of Beneficial Interest, accompanied by Assignments from the former holders thereof to The Ajax Company, were immediately transmitted to Seattle-First National Bank, as Trustee under said trust, together with a written request that the assets of said trust be distributed to The Ajax Company as sole beneficiary thereunder. Exhibit H is a copy of said written request (Admitted Fact XXIII, R. 91).

In response to said request, Seattle-First National Bank delivered the mortgage notes and the collateral held as security therefor to The Ajax Company, together with an instrument of transfer entitled "Transfer of Assets Upon Distribution of Trust." Exhibit I is a copy of said instrument of transfer (Admitted Fact XXIV, R. 91, 92).

Upon receipt of the mortgage notes and collateral, The Ajax Company immediately assigned and delivered them

to The Bank of California, N.A. as security for the indebtedness of The Ajax Company to The Bank of California, N.A. in the amount of $642,000. Exhibit J is a copy of said assignment, and Exhibit K is a copy of the receipt issued by said bank to The Ajax Company for said collateral (Admitted Fact XXV, R. 92).

The aggregate net purchase price for the 119,112 beneficial interests purchased by Ajax as hereinabove stated was the sum of $774,228 (Admitted Fact XXVII, R. 92).

The Ajax Company received the following amounts from the subscribers for its stock and notes:

For 12,928 shares of stock at $1.00 per share,	$ 12,928.00
For 5-year 6% notes at face value	129,300.52
TOTAL	$142,228.52

The balance of the funds necessary to complete the purchase were from the proceeds of the bank loan made by Ajax from The Bank of California in the amount of $642,000 (Admitted Facts XXVIII, XXIX, R. 93; Finding of Fact No. 7, R. 126).

As of February 21, 1957, the date of the purchase, no payments on the principal of the indebtedness evidenced by the mortgage notes had been made, but all accrued interest thereon had been paid except interest for the two years ended 3/31/54 and 3/31/55,[6] and interest for the current year ending 3/31/57 which was not yet payable (Admitted Fact XXVII, R. 92).

On April 2, 1957, interest on the mortgage notes for the year ended March 31, 1957 in the amount of $66,-

(6) Interest for these years had been deferred until May 31, 1960 by previous agreement between Appellant Taxpayer and Seattle-First National Bank (Admitted Fact XXVII, R. 92).

737.28 was paid by appellant taxpayer to Ajax. On May 17, 1957, $60,000 of said funds was paid by Ajax to the bank and applied in payment of interest and reduction of principal of that company's indebtedness to the bank. Pursuant to action by the Board of Directors of appellant taxpayer taken at its annual meeting, May 17, 1957, and approved by its stockholders at their annual meeting held on the same day, on May 23, 1957, appellant taxpayer made a principal payment in the amount of $400,000 to Ajax on the indebtedness evidenced by said mortgage notes. None of the principal of said notes was then due and payable, and said $400,000 payment constituted a pre-payment of principal. Exhibits AA and BB are copies of the Minutes of said stockholders and directors meetings of appellant taxpayer. Out of the funds so received, Ajax paid the bank the sum of $399,677 in payment of accrued interest to date on its bank loan, and the balance in reduction of principal (Admitted Facts XXIX, XXX, XXXVI, R. 93, 94, 97; Exs. O, Q; Tr. 34, 35, 128).

On October 2, 1957, Ajax paid the accrued interest on its said bank loan to date and executed a renewal note to the bank for the principal balance in the amount of $192,000. Thereafter, Ajax paid the accrued interest on said renewal note monthly to the bank (Admitted Fact XXIX, R. 94, Ex. Q).

On April 4, 1958, accrued interest on the mortgage notes for the year ended March 31, 1958 was paid by appellant taxpayer to Ajax. However, no further principal payments were made by Ajax on its bank loan until March 6, 1959, when a payment of $40,000 was made, reducing the bank indebtedness to $152,000. Thereafter, additional

principal payments on its bank loan by Ajax were made as follows: On June 20, 1960, $52,000; on March 2, 1961, $50,000; and the final principal balance of $50,000 on March 1, 1962 (Admitted Fact XXX, R. 94, Ex. Q).

Appellant taxpayer's Alaska salmon fishing operations during the 1958 season were relatively successful and resulted in a substantial profit. However, the immediate prospect of the elimination of salmon traps in Alaska and other problems created by Alaska statehood caused certain of the directors and stockholders of appellant taxpayer to be pessimistic with respect to the prospects for the 1959 season. A meeting of the Board of Directors of appellant taxpayer was held December 10, 1958, at Seattle, Washington, to consider the situation. It was the sense of the meeting that due to these problems, a further study of the situation was required to better determine the future course of the business and operations of the company. Consequently, said meeting was adjourned to January 14, 1959, when it was reconvened at the California Club, Los Angeles, California. At the reconvened meeting, the question of determining the future course of the company and its business in view of the Alaska situation was considered at length. In this connection, the following possibilities were considered: First, dissolution and liquidation of the company; second, consolidation of the operations of the company with those of Peninsula Packers[7]; third, the purchase by Mr. Bez and Mr. Tuerk of the stock and notes held by the other stockholders and noteholders of the company. Substantial objections were raised as to each of these possibilities. Two of the di-

(7) See footnote (5). Peninsula Packers was also engaged in the salmon canning business in Alaska.

rectors then joined in a suggestion that Mr. Bez be given an option on all of the stock and notes of appellant taxpayer and Ajax held by the other persons present at the meeting, the price to be the par value of the stock and the face value of the notes. It was a part of this proposal that the option run to March 31, 1959, but that it be given on condition that no decision would be made during the period of the options to operate or not to operate appellant taxpayer's plants for the coming season, and that Mr. Bez would not permit any substantial funds of the company to be committed for the operation of the company's plants during that time unless he was instructed to do so by the Board. Exhibits CC and DD are copies of the minutes of said meetings (Tr. 38-50, 113, 114, 128-134; Deposition of Jacques Bergues, 12/6/66, pp. 15-17; Admitted Facts XXXVI, XXXVII).

All parties present at the meeting indicated that they would be willing to give such an option to Mr. Bez and that they would use their best efforts to persuade the other security holders whom they respectively represented to join in such an option (Ex. DD).

Accordingly, options in the form set out in Exhibit FF were prepared and forwarded to each of said directors[8] with a letter confirming Mr. Bez' assurance that no decision would be made to operate appellant taxpayer's plants or to commit substantial funds for such operations unless he was instructed by appellant taxpayer's Board to do so (Admitted Fact XXXVII, R. 97, Ex. EE).

By March 6, 1959, Mr. Bez had received options cov-

(8) Donald Royce, Fred R. Tuerk, Thos. J. Bannan and Jacques Bergues; and also to George Darneille, a stockholder, who had been present at the meeting (Exs. DD, EE).

ering all outstanding stock and unsecured notes of appellant taxpayer and of Ajax, except as indicated below:

Appellant Taxpayer

	Stock	*Notes*
Covered by Options	10,941.9 shares	$510,581.00
Owned by Peninsula Packers	2,735.0 shares	127,650.00
Owned by Trans-Pacific Fishing & Packing Co.	352.0 shares	16,480.00
Owned by Nick Bez	442.1 shares	20,579.00
Total	14,471.0 shares	$675,290.00

The Ajax Company

	Stock	Notes
Covered by Options	9,898.5 shares	$ 94,007.37
Owned by Peninsula Packers	2,735.0 shares	27,350.00
Owned by Trans-Pacific Fishing & Packing Co.	352.0 shares	3,520.00
Owned by Nick Bez	442.5 shares	4,423.15
Total	12,928.0 shares	$129,300.52

(Admitted Fact XXXVIII, R. 97).

Said options were taken by Mr. Bez for the benefit of the partnership Peninsula Packers,[9] and, on March 4, 1959, an Amendment to Partnership Agreement was executed by the partners providing for the assignment to Ajax of the options to purchase the appellant taxpayer stock and Ajax notes; the assignment to appellant taxpayer of the options to purchase the appellant taxpayer notes; the contribution to the partnership of the securites of appellant taxpayer and Ajax owned by Nick Bez and Trans-Pacific Fishing & Packing Co.; and the contribution to Ajax of all appellant taxpayer stock owned by the partner-

(9) See footnotes (5) and (7).

ship (Admitted Facts XXXVIII, XXXIX, R. 97-99; Ex. HH).

The options were assigned and exercised accordingly and Seattle-First National Bank was appointed to receive the securities on behalf of the purchasers and to disburse the option price to the sellers. This was accomplished in accordance with the terms of a letter of instructions from Nick Bez, Peninsula Packers, The Ajax Company, and appellant taxpayer to the bank (Admitted Fact XXXVIII, R. 98, 99; Ex. GG).

As a result of the purchase of the securities covered by the options as above stated, and the contribution of the appellant taxpayer stock already owned by Peninsula Packers to The Ajax Company, as above stated—

1. Peninsula Packers became the sole stockholder of The Ajax Company; and

2. The Ajax Company became the sole stockholder of appellant taxpayer (Admitted Facts XXXIX-XLII, R. 99, 100; Exs. HH, II, JJ).

The Ajax Company has remained the sole stockholder of appellant taxpayer at all times since (Admitted Fact XLI, R. 99).

The Peninsula Packers Amendment to Partnership Agreement above referred to (Ex. HH) also provided that Trans-Pacific Fishing & Packing Co. would contribute ten gill net boats which it owned in Alaska to the partnership, and that the partnership would, in turn, contribute all floating equipment which it owned, including the ten gill net boats above mentioned, its Naknek campsite inventory and supplies, and all other miscellaneous

operating equipment, supplies and furniture to The Ajax Company. Peninsula also agreed to contribute 1,000 shares (all) of the stock of Global Fishing Company to Ajax.

These contributions were accepted by resolution of the Board of Directors of Ajax at a meeting held March 25, 1959 and all tangible operating equipment and supplies so received by Ajax were, in turn, contributed to the capital of appellant taxpayer except the vessels *Nomad* and *Deer Harbor*, which were retained by and are still owned by Ajax. Exhibit JJ is a copy of the minutes of this meeting. The *Nomad* has not been operated, but the *Deer Harbor* has been operated by The Ajax Company as a cannery tender in Alaska and for transporting fishing equipment and supplies between Puget Sound and Alaska during each of the fishing seasons 1959-1965 (Admitted Fact XLII, R. 99, 100).

After acquiring all of the stock of Global Fishing Company on March 25, 1959, The Ajax Company caused Global Fishing Company to be merged into appellant taxpayer, and said merger became effective July 1, 1959. Global Fishing Company had been actively engaged in the fishing industry since its organization in 1950, and in Alaska since the 1954 fishing season (Admitted Fact XLII, R. 100).

The operations of appellant taxpayer's business require large borrowings from banks, particularly prior to and during the Alaska salmon fishing season, to finance its salmon pack. Large bank credits are also required in connection with the purchase of salmon packed by others. In this connection, appellant taxpayer has been dependent upon the lines of credit extended to it by its

banks. Upon the acquisition of all of the outstanding stock of appellant taxpayer by The Ajax Company, the banks indicated that it would be desirable to eliminate the mortgage indebtedness owing by appellant taxpayer under the mortgage notes. However, as above stated, said mortgage notes were held by The Bank of California as collateral for the balance owing by Ajax on its loan from the bank. Consequently, on June 29, 1959, Ajax entered into a letter agreement (Ex. LL) with the bank, whereby Ajax agreed to pledge all of the issued and outstanding stock of appellant taxpayer to the bank to secure said loan, and the bank agreed to accept said stock as substitute collateral and release the mortgage notes from its pledge. Ajax further agreed that upon the release to it of the mortgage notes, it would contribute them to the capital of appellant taxpayer so that said mortgage indebtedness would be converted into equity capital of appellant taxpayer. Said substitution of collateral was effected and, upon the release of said mortgage notes by the bank to Ajax, Ajax contributed the same to the capital of appellant taxpayer. Entries were made in appellant taxpayer's books of account to reflect an increase in its paid-in capital in the amount of the unpaid balances under said mortgage notes and a corresponding reduction in its long-term debt (Admitted Facts XXXIV, XLIV, R. 94, 100, 101; Exs. KK, LL, MM).

Since its organization on May 21, 1956, The Ajax Company has maintained separate books of account, has filed Federal income tax returns for each of its fiscal years, commencing with the year ended March 31, 1957, and has held regular stockholders' and directors' meetings (Admitted Fact XLV, R. 101).

SPECIFICATION OF ERRORS

The specification of errors relied upon and which are intended to be urged are as follows:

1. The trial court erred in concluding that the substantive corporate existence of Ajax should not be recognized for Federal tax purposes because tax avoidance was the primary, dominant and moving purpose for its formation and for its single business activity (Memo. Dec., R. 115-118). Said conclusion is erroneous in that negotiations for and the purchase of mortgage notes at a discount from unrelated third parties is a business activity with a clear commercial purpose; and the fact that appellant taxpayer could have purchased them does not rob the purchase by Ajax of its character as a business activity to be recognized as such for Federal tax purposes, whatever tax avoidance motives may have been involved.

2. The trial court erred in concluding that appellant taxpayer's mortgage notes were in substance purchased by appellant taxpayer and should be so treated for purposes of determining the Federal income tax liability; and that, accordingly, appellant taxpayer realized taxable income under Section 61(a)(12) of the Internal Revenue Code of 1954 upon the purchase of said notes at a discount (Conclusion of Law No. 1, R. 127). Said conclusion is erroneous in that the Admitted and Stipulated Facts (R. 84-104) and undisputed evidence establish that said mortgage notes were purchased by The Ajax Company and not by appellant taxpayer; and no legal basis exists for attributing the purchase of said notes to appellant taxpayer for purposes of determining its Federal income tax liability.

3. The trial court erred in concluding that the net operating loss deductions claimed by appellant taxpayer are disallowed by Section 269(a) of the Internal Revenue Code of 1954 (Conclusion of Law No. 2, R.127). Said conclusion is erroneous in that (i) neither appellant taxpayer nor Ajax acquired control over the other, and the acquisition of such control is essential to the application of Section 269(a); and (ii) appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed.

4. The trial court erred in finding that 85.44 per cent of appellant taxpayer's stockholders committed themselves to purchase Ajax stock and five-year notes (Finding of Fact No. 5, R. 125). Said finding of fact is erroneous in that it is contrary to the stipulated facts contained in the exhibits jointly offered by both parties (Exs. R, S, SS).

5. The trial court erred in finding that appellant taxpayer paid Ajax $66,737.38 on May 17, 1957 (Finding of Fact No. 8, R. 126). Said finding of fact is erroneous in that it is stipulated by the parties that said payment was in fact made on April 2, 1957 (Admitted Fact No. XXX, R. 94).

6. The trial court erred in entering the Judgment of Dismissal (R. 128) and in failing to enter judgment for appellant taxpayer on the issues presented.

SUMMARY OF ARGUMENT

The argument falls into two basic parts, first, a discussion of the legal consequences of a purchase of an indebtedness at a discount by a corporation organized for

that purpose by a majority of the stockholders of the debtor corporation where the primary purpose of doing so was tax avoidance and, second, a discussion of the application of Section 269(a)(1) to the transactions involved in this proceeding.

The argument may be summarized as follows:

Part I: The admitted facts establish (a) that appellant taxpayer did not, in fact, purchase the mortgage notes, and (b) that Ajax was organized by stockholders of appellant Taxpayer for the purpose of purchasing the mortgage notes and did, in fact, purchase them.

It has been firmly established by the authorities that the motive of tax avoidance will not establish tax liability if the transaction does not do so without it, and the purchase of an indebtedness at a discount by stockholders of the debtor corporation, or by a new corporation organized by them for that purpose, does not constitute an acquisition of the indebtedness by the debtor corporation. Thus, the trial court's determination that the purchase of the mortgage notes by Ajax must be attributed to appellant taxpayer solely on the basis that the primary purpose of the organization of Ajax and its purchase of the mortgage notes was tax avoidance, is error.

Part II: Section 269(a)(1) cannot apply to the situation here involved because appellant taxpayer did not acquire control of Ajax, nor did Ajax acquire control of appellant taxpayer. The acquisition of such control is essential to the application of this section, and the fact that two corporations have the same, or largely the same, stockholders does not constitute control by one of them over the other within the meaning of this section.

Section 269(a)(1) cannot apply for the additional and independent reason that appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not have otherwise enjoyed. The operating loss deductions in question will be enjoyed in full, either by application in the year ended March 31, 1957, as the Government contends, or by application in the years ended March 31, 1960, and March 31, 1961, as appellant taxpayer contends. The Government does not seek to disallow any portion of the deductions, but merely to charge appellant taxpayer with additional tax in the earlier year, whereby the benefit of the operating loss deductions would be enjoyed in that year rather than in later years.

ARGUMENT

Part I

The Section 61 Issue[10]

The Mortgage Notes Were Acquired by Ajax On Behalf of Its Stockholders, Not by Appellant Taxpayer.

There is no dispute as to the material facts in this proceeding. They are largely stipulated as Admitted Facts in the Pre-Trial Order and by the exhibits referred to in the Admitted Facts or otherwise jointly offered by the parties (R. 112).

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(10) Section 61(a)(12) of the Internal Revenue Code of 1954, insofar as claimed by the Government to be applicable, provides as follows:

"Sec. 61. GROSS INCOME DEFINED

"(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * *

"(12) Income from discharge of indebtedness;

* * *"

For the full text of Section 61(a), see Appendix A, page A-I, *infra*.

The issue in this phase of the case is the correct legal consequences to be derived from these facts.

It has been stipulated that when the possibility of acquiring the mortgage notes at a discount arose, Mr. Bez, its president, became interested in the acquisition of the notes by appellant taxpayer to the extent that he inquired of its legal and accounting advisors as to the Federal income tax consequences in the event appellant taxpayer were to acquire the notes. He was advised that any acquisition of the notes by appellant taxpayer at a substantial discount would result in the realization of taxable income in an amount equal to the discount. It is stipulated that on the basis of this advice, he concluded that it would not be feasible for appellant taxpayer to attempt to acquire the notes. It is further stipulated that his reason for arriving at this conclusion was that the immediate income tax liability which would be incurred as a result of the acquisition would increase the overall cost of the notes to an amount which appellant taxpayer could not afford to pay (Admitted Fact XIV, R. 87, 88). The evidence shows that but for the impact of the tax, it would have been desirable for appellant taxpayer to attempt to purchase the notes. Thus, under the stipulated facts and undisputed evidence, the primary, if not the sole, reason that appellant taxpayer abandoned the idea of purchasing the notes was that to do so would incur an unacceptable tax liability. This has been stipulated and openly conceded by appellant taxpayer throughout this entire proceeding, and this tax avoidance motive on the part of appellant taxpayer is not denied.

It also cannot be denied, however, that appellant taxpayer had a perfect right to elect not to purchase the

notes, and that the tax consequences of doing so was a perfectly legitimate reason for its decision. Under the circumstances, it would have been most improvident for appellant taxpayer to have made the purchase.

It is further stipulated that having determined that a purchase of the notes by appellant taxpayer was not feasible, Bez, who was a substantial stockholder, began to explore the possibility of joining with other stockholders for the purpose of attempting to purchase the notes; that he caused the Ajax Company to be organized for that purpose; that he solicited the other stockholders for subscriptions for stock and notes of Ajax; that a large majority agreed to subscribe providing $142,228.52 toward the funds necessary to make the purchase; that arrangements were made on behalf of Ajax to borrow the balance of the necessary funds from The Bank of California; that Ajax made a formal offer to 68 holders of the beneficial interests under the trust which held the mortgage notes; that Ajax' offer was accepted by all of them; that Ajax borrowed $642,000 form the bank to make up the balance of the purchase price; that the purchase was completed and the mortgage notes, together with the mortgages which secured them, were assigned to Ajax; and that Ajax immediately pledged and delivered the mortgage notes to the bank as collateral for its bank loan (Admitted Facts XV-XXX, R. 88-94).

Again, it cannot be denied that the stockholders had a perfect right to purchase these notes if they chose to do so, and a perfect right to organize and employ a separate corporation as a vehicle to accomplish that purpose. The fact that it would have been desirable for appellant taxpayer to purchase the notes, that appellant

taxpayer may have been able to purchase them if it could have afforded to do so, and the fact that the stockholders undoubtedly had a special interest in purchasing these notes because of their interest in appellant taxpayer, can in no way bar or limit the right of the stockholders to purchase the notes if they wished to do so.

The Government contends that the corporate entity of Ajax should be disregarded because its purchase of the mortgage notes was a sham transaction entered into solely to escape taxation and having no commercial or industrial purpose (R. 115). The trial court, however, carefully refrained from characterizing either Ajax, as such, or the purchase of the mortgage notes as sham. On the contrary, the court below recognized the purchase of the mortgage notes by Ajax as "its single business activity" (R. 116, 117; Finding of Fact No. 9, R. 126). It held, however, that without the purpose of tax avoidance, Ajax would never have been organized and, that since tax avoidance was the primary, dominant, moving purpose for the formation of Ajax and for its single business activity in purchasing the mortgage notes, the substantive corporate existence of Ajax should not be recognized for Federal tax purposes (R. 117).

How such a determination would result in the attribution of the purchase to appellant taxpayer rather than to the stockholders of Ajax is not explained.[11]

As above stated, however, it has been expressly stipulated by the parties:

1. That appellant taxpayer did not, in fact, purchase the mortgage notes; and

(11) See page 54, *infra*.

2. That stockholders of appellant taxpayer organized Ajax to buy the notes and contributed their own personal funds in a substantial amount for that purpose, and that Ajax did, in fact, buy the notes and hold and deal with them as the owner.

The sole basis relied on by the trial court for attributing the purchase to appellant taxpayer was its determination above stated, that tax avoidance was the primary, dominant, moving purpose for the formation of Ajax and its purchase of the mortgage notes (R. 117).

That this was error is fully demonstrated by the authorities.

The Motive of Tax Avoidance Will Not Establish Liability if the Transaction Does Not Do So Without It.

The basic principle established by the Supreme Court in the case of *Gregory v. Helvering*, (1935) 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596, stated in the subheading above has been the subject of countless decisions of the Federal courts and of the Tax Court. One of the best known and most cited of these cases is the decision of the Second Circuit Court of Appeals by Judge L. Hand in *Chisholm v. Comm'r* (2d Cir. 1935), 79 F.2d 14. This case explains the essence of this principle with great clarity and highlights the true significance of a tax avoidance purpose on the part of a taxpayer.

In that case, Chisholm and his brother each owned 300 shares of stock in an engineering corporation. Together with the other stockholders of the corporation, they granted a thirty-day option for the sale of this stock. If consummated, the sale would result in a large capital gain. The brothers' attorney told them that by forming a partnership they might postpone and perhaps altogether escape the taxes which would otherwise become due upon the sale. For this reason they formed a

partnership and transferred to it the shares of stock in question and its only asset. Two days later, the option was exercised and the stock sold by the partnership. The partnership was not dissolved and was still in existence at the time of the trial. The brothers continued to hold its assets in common as partners, bought and sold securities with the capital, and had not distributed any principal. The commissioner assessed deficiencies against each partner on the theory that he had realized a gain on the sale of the stock, and the Board of Tax Appeals affirmed this ruling. The Board's decision is reversed by the Court of Appeals.

The basis of the Board's decision was that the partnership was formed confessedly to escape taxation. In this connection, the court said (at page 15):

> "The Board thought that for this reason the transaction was not 'bona fide,' and that the business of the firm was not business properly speaking at all. The commissioner believes that the situation falls within *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596. It is important to observe just what the Supreme Court held in that case. It was solicitous to reaffirm the doctrine that a man's motive to avoid taxation will not establish his liability if the transaction does not do so without it. It is true that that court has at times shown itself indisposed to assist such efforts, * * * (citing cases) * * *; but it has never, so far as we can find, made that purpose the basis of liability; and it has often said that it could not be such. The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance. * * * We may assume that purpose may be the touchstone, but the pur-

> pose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation which the apparent, but not the whole, transaction would realize. In *Gregory v. Helvering, supra,* * * *, the incorporators adopted the usual form for creating business corporations; but their intent, or purpose, was merely to draught the papers, in fact not to create corporations as the court understood that word. That was the purpose which defeated their exemption, not the accompanying purpose to escape taxation; that purpose was legally neutral. Had they really meant to conduct a business by means of the two reorganized companies, they would have escaped whatever other aim they might have had, whether to avoid taxes, or to regenerate the world."

On the basis of the above stated principles, the court held that since an enduring partnership had, in fact, been formed and had continued to hold the joint principal and to invest and reinvest it, the fact that the dominant or sole purpose for its formation was to escape taxation would not alter its tax status.

The basis of the trial court's holding in the case at bar is precisely the same as that of the Board of Tax Appeals in *Chisholm.* Based solely on his finding that the purpose for forming Ajax and the purchase of the mortgage notes by Ajax was tax avoidance (Finding of Fact No. 10, R. 127), he has concluded that such purchase of the notes was not business, properly speaking, at all (Memo. Dec., R. 116, 117). Thus, the trial court has fallen into the same error as the Board in *Chisholm,* that the motive to avoid taxation does indeed establish a taxpayer's liability where the transaction would not do so without it. The purchase of mortgage notes at a discount from unrelated taxpayers could not, under any circumstances, result in tax liability unless the notes are actually or constructively acquired

by the debtor. Thus, if the purchase by Ajax, which was not the debtor, would not constitute an acquisition by the debtor without the tax avoidance motive, the existence of the tax avoidance motive would not change the situation. The question as to whether or not the relationship of appellant taxpayer and its stockholders would, absent a tax avoidance motive, result in the attribution of the acquisition to appellant taxpayer, will be discussed at a later point in this brief.

As in *Chisholm*, Ajax has not dissolved and is still in existence (Admitted Facts XLI, XLII, R. 99, 100). During the period from the date of the acquisition of the mortgage notes until March 25, 1959, the business activity of Ajax was confined to holding the mortgage notes and related activities such as receiving the payments made thereon, servicing its bank loan, paying interest to its own note holders, filing income tax returns, and holding corporate meetings (Admitted Facts XXIX, XXX, XL, XLV, R. 93, 94, 99, 101; Tr. 56). On March 25, 1959, Ajax became the sole stockholder of appellant taxpayer and remains so to the present time. In addition, Ajax has engaged in substantial fishing operations in Alaska during each fishing season commencing with the 1959 season (Admitted Facts XLI, XLII, R. 99, 100).

Under the stipulated facts there can be no doubt that the stockholders in the case at bar really meant to conduct the business of negotiating for and purchasing the mortgage notes by means of Ajax and, as so aptly stated in the above quotation, have thus "escaped whatever other aim they might have had, whether to avoid taxes, or to regenerate the world."

Another decision, by the Fifth Circuit, which points up the common error which so often occurs in applying the rule of *Gregory* is *Sun Properties v. U.S.*, (5th Cir. 1955) 220 F.2d 171. In that case, the question was whether the conveyance of a warehouse property to the taxpayer corporation by its sole stockholder, in the form of a sale, was in substance a contribution to capital. Shortly after the corporation was organized, the stockholder sold the warehouse to it for $125,000 payable in semi-annual installments of $4,000 without interest. The trial court held that the transaction was made to reduce taxes and achieved no legitimate business purpose, and that the stockholder would not have entered into the transaction except for tax purposes. On this basis, it held that the transaction constituted a contribution to capital rather than a sale.

With respect to the trial court's determination that the decisive consideration motivating the transaction was the minimizing of taxes and that such was the only business purpose of the transaction, the Circuit Court said at page 174:

> "What about the fact, which we may assume to be true, that Peacock's predominant motive was to minimize taxes? In *Gregory v. Helvering*, 293 U.S. 465, 469, 55 S.Ct. 266, 79 L.Ed. 596, 97 A.L.R. 1355, the Supreme Court said that a motive of tax avoidance will not establish liability if the transaction does not do so without it. It may fairly be said that a tax avoidance motive must not be considered as evidence that a transaction is something different from what it purports to be. 8th Ann. N.Y.U. Institute on Federal Taxation 990, 1003:
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> > " 'Transactions are properly subject to careful scrutiny when the only ascertainable motive is tax avoidance, just as they are subject to scrutiny

> when between the members of a family. The error into which the courts have fallen, however, is that they have elevated the rule of careful scrutiny into a rule which changes the substantive effect of the evidence found. Although transactions like these should be carefully studied they should be treated for tax purposes, on the basis of this careful study, just like tax cases where tax avoidance is not a motive.'"

As stated by the court with respect to the error above referred to:

> "This rationale is perilously plausible. It is in effect saying to the taxpayer, 'You did this under suspicious circumstances; therefore, you did not do it at all and you are not entitled to any tax advantages.'" 220 F.2d at 173

On this basis, the Circuit Court held that since the transaction in question was carried out as a sale in all respects, the fact that the sole motive was tax avoidance would not justify treating it as something else, since (page 174):

> "'* * * Legal transactions cannot be upset merely because parties have entered into them for purpose of minimizing or avoiding taxes which might otherwise accrue'."

The error pointed out above in the quotation from the N.Y.U. Institute on Federal Taxation in *Sun Properties* is especially well illustrated by the action of the Tax Court, which is reversed in *Friedlander Corp. v. Comm'r,* (5th Cir. 1954) 216 F.2d 757. In that case, a family partnership composed of substantially all of the stockholders of the taxpayer corporation was formed to take over the larger portion of the department store and hardware business of the corporation. The primary motive for forming the partnership was to reduce tax

liability. In reversing the decision of the Tax Court, the Circuit Court said at page 759:

> "For here, the majority, rejecting the stipulated and undisputed facts that the partnership was formally created and activated, and for years carried on a large business, and seizing, as determinative of the question at issue, upon the admitted fact that the partnership was formed because of the advice of a tax accountant and consultant that there would be less liability if the stores were owned by a partnership, and stating: 'The primary motive for forming the partnership was to reduce tax liability,' concluded in the teeth of the overwhelming, indeed undisputed, oral and physical evidence to the contrary, that 'The parties did not in good faith and acting with a business purpose intend to join together as partners in the present conduct of an enterprise.' So concluding, and without a syllable of evidence or a real fact to the contrary, it erroneously declared and held that the large income in fact earned by the partnership and its members throughout the years was not earned by it but by the petitioner and was, therefore, taxable not to the partnership but to it."

In commenting upon the manner in which the Tax Court had dealt with the case, the court said at page 759:

> "Saying, and thus giving lip service to the settled rule of law, 'that a taxpayer may select any form or organization through which to conduct business and is under no compulsion to adopt a type that will yield the greatest amount of tax revenue,' and again, 'Louis, the architect of the plan, testified, in effect, that taxation was the predominant motive for creation of the partnership. Such a purpose, if the plan for its accomplishment is not unreal or a sham, is of course not fatal. * * *,' the majority proceeded by the same kind of unpermissible fiating which has been condemned in the cases, to attribute to petitioner income earned not by it but by the partnership."

The court also pointed out that the Tax Court's determi-

nation in the particular case ran counter to settled law established by numerous Federal cases and by the Tax Court itself in prior cases.

As stated by this court in *Twin Oaks Co. v. Comm'r,* (9th Cir. 1950) 183 F.2d 385, the error in dealing with the tax avoidance motive which is pointed up in the cases just discussed often results in the denial to a taxpayer of the legal right to conduct his business affairs through the medium of his own choice. Where the acts of a partnership are held to be in substance the acts of a corporation, or the acts of one corporation are held to be in substance the acts of another corporation, solely on the basis of the existence of a tax avoidance motive, the legal right of the taxpayer to conduct his business affairs through the medium of his own choice is effectively denied. In *Twin Oaks,* two individuals and the wife of one of them owned all of the stock of the taxpayer corporation which was engaged in the business of dealing in builder's materials. The stockholders entered into a partnership and took over the business of the corporation, purchasing its operating assets and leasing its real estate on which the business was conducted. The commissioner assessed tax deficiences against the corporation on the theory that the partnership had been created solely as a device to avoid taxes and, hence, the profits of the partnership should be taxed to the corporation. The Tax Court sustained the assessment on the ground that the transfer of the operating assets of the corporation to the partnership had been "forms without substance" and were not entitled to recognition for tax purposes.

The decision of the Tax Court is reversed. The Cir-

cuit Court states that there could be no doubt that it was the intent of the parties to thereafter conduct the business as a partnership, that the partnership was actually formed, that the corporate stockholders as members of the partnership were subject to unlimited personal liability in place of the limited liability to which they had previously been subject, and that the profits of the business were thereafter distributed among the partners in accordance with the agreed partnership interests and not in accordance with their stock holdings in the corporation.

With respect to the situation thus presented, this court said at page 387:

> "It is, as the Tax Court observed, well settled that a taxpayer is free to adopt such legal organization for the conduct of his affairs as he may choose; he may convert from the corporate method to the partnership method of doing business and, though his motive in so doing be to reduce taxes, the conversion must be accorded recognition unless it is such a sham, such a change in form only, without substance, as to require that it be disregarded for tax purposes. *Helvering v. Clifford,* 309 U.S. 331, 60 S.Ct. 554, 84 L.Ed. 788. It seems clear to us, however, that the Tax Court, in its characterization of the change in business structure involved in the instant case as a sham and a mere form without substance, has, in effect denied the taxpayers the legal right to conduct their business affairs through a medium of their own choice."

As in *Twin Oaks,* in the case at bar there can be no doubt that Ajax was actually formed by stockholders of appellant taxpayer for the purpose of acquiring the mortgage notes, that such stockholders contributed substantial amounts of their own personal funds to Ajax, that some

of appellant taxpayer's stockholders did not participate, that others participated to a greater or lesser extent than their participation in appellant taxpayer, that Ajax actually purchased the notes and borrowed substantial funds from a bank to do so, and dealt with the notes as the owner thereof. It was clearly the legal right of these stockholders and of Ajax to do this, and the decision of the trial court effectively denies them this right.

To the same effect in the Tax Court see also: *Acampo Winery & Distilleries, Inc.*, (1946) 7 T.C. 629, 635, 636.

Negotiations for and Purchase of Mortgage Notes at a Discount From Unrelated Third Parties Is a Legitimate Business Activity With a Clear Commercial Purpose.

In order to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial or other activity besides avoiding taxation. In other words, the term "corporation" is interpreted to mean a corporation which does some "business" in the ordinary meaning, and escaping taxation is not "business" in the ordinary meaning. *Nat'l Investors Corp. v. Hoey,* (2d Cir. 1944) 144 F.2d 466. As the cases previously discussed clearly show, however, this does not mean that an activity which is clearly a business activity is robbed of its character as such simply because the taxpayer's motive was to avoid taxation. The point made by *Hoey* is that a corporation does not qualify as a separate jural person merely by existing and doing nothing. Judge Hand points out that this doctrine has sometimes been understood to contradict the doctrine that the motive to avoid taxation is never, as such, relevant, but states at page 468:

"In fact it does not trench upon that doctrine; *"

As a matter-of-fact, *Hoey* affirmatively recognizes that minimal activity on the part of a corporation is all that is required. Thus, in *Hoey*, a subsidiary organized by the taxpayer to take and hold common stock and warrants of three of the other subsidiaries of the taxpayer pending consummation of a reorganization plan, was held to be engaged in business. When the reorganization plan failed and there was no longer any reason for continuing the subsidiary in existence, it was held that the subsidiary was no longer engaged in business, notwithstanding the fact that it still retained the securities which had been transferred to it.

The negotiation for and purchase of the mortgage notes at a discount from third parties under circumstances such as those presented in the case at bar certainly constitute a business activity with a clear commercial purpose. This does not appear to be denied. The point made by the trial court is that the purchase by Ajax was motivated solely by tax avoidance because the notes could have or should have been purchased by appellant taxpayer, and that it is this circumstance that robs the purchase by Ajax of its character as a business activity. Such a conclusion, in the words of *Hoey*, clearly would trench upon the doctrine that the motive to avoid taxation is never, as such, relevant (144 F.2d at p. 468).

If such were the rule, any act or activity engaged in through the instrumentality of a corporation for the purpose of minimizing taxes would be robbed of its otherwise true character as a business activity. The common business practices which would thus be challenged would be beyond number.

The authorities discussed in the preceding subsection of this brief, as well as *Hoey,* make it clear that this cannot be the rule.

The Purchase of an Indebtedness by the Stockholders of the Debtor Corporation, or by a New Corporation Organized by the Stockholders for That Purpose, Does Not Constitute an Acquisition of the Indebtedness by the Debtor Corporation.

In the case at bar, appellant taxpayer and the Ajax Company are what is sometimes referred to as brother and sister corporations; that is, two corporations with a substantial identity of stockholders. This is a common relationship in many areas of corporate activity where for one reason or another various business activities or various segments of a single business activity have a common ownership but are conducted by separate corporate entities. In this form of corporate structure, the related corporations do not hold stock interests in each other as in the case of parent and subsidiary corporations. On the contrary, their relationship is based solely on the circumstance that the stock of each of them is held by the same or largely the same stockholders. Thus, in the present case, appellant taxpayer owned no stock interest in Ajax, and Ajax owned no stock interest in appellant taxpayer, at least until March 25, 1959. As observed by the trial court in its memorandum decision, there was a close stockholder relationship between the two corporations (R. 116). However, as outlined in the Statement of Facts above, there was at the same time a substantial divergence in the stockholdings of the two corporations (Exs. R, S, SS).

However, it is firmly established by the authorities that where one party acquires the debt of another the relationship of the parties one to the other does not change the character of the transaction. Thus the acquisition of an indebtedness by the stockholders of the debtor corporation does not constitute an acquisition of the indebtedness by the debtor corporation *Koppers Co.*, (1943), 2 T.C. 152. The fact that the stockholders organize and employ a separate corporation as a vehicle to accomplish the purchase, merely takes the transaction another step removed from a direct purchase by the stockholders, especially where less than all of them participate in the venture.

In *Koppers Co., supra,* the taxpayer, Koppers Co., was a corporation which owned all of the stock of a subsidiary corporation, Koppers Products Co. The subsidiary had $6,050,000 in bonds outstanding in the hands of the public. The taxpayer purchased all but a few of these bonds from the various holders thereof for a total purchase price of $5,163,507.18. In order to provide part of the financing for the acquisition of the bonds, Koppers Co. borrowed $1,500,000 from the subsidiary. Shortly after this acquisition the taxpayer corporation caused the subsidiary to call the entire bond issue for redemption in accordance with its terms. The bonds thus acquired by the taxpayer were redeemed at the call price, which was slightly over $500,000 more than the taxpayer paid for the bonds. After the redemption of the bonds by the subsidiary was completed, the taxpayer caused the subsidiary to be dissolved.

The commissioner asserted that the acquisition of the bonds by the taxpayer at a discount resulted in income

to the subsidiary and assessed tax against the subsidiary accordingly. This tax was then assessed against the taxpayer as transferee of the subsidiary. The taxpayer, of course, conceded recognition of gain by itself when the bonds were redeemed, but had offsetting losses for the year sufficient to cover any gain thus realized.

The Tax Court stated that the question presented was as follows (page 156):

> "The question to resolve, therefore, is whether the petitioner has in fact here brought about the evasion of tax by its subsidiary by causing a transaction, actually that of the subsidiary, to be carried out in petitioner's name and the profit thereon to be reflected as realized by it."

In deciding that no basis existed for attributing income to the subsidiary as a result of this transaction, the Tax Court said (2 T.C. at p. 157):

> "Here the character of the deal is not unusual and could as probably have occurred with a stranger. It is true that the taxpayer here was a controlled corporation. Nothing, however, was taken from it or conveyed to it over and above what would have passed between petitioner and an uncontrolled corporation in a similar transaction.
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> "This was a purchase which petitioner had a perfect right to make. It used its own funds for the purchase. It bought the bonds on the market for itself. Thereupon, as owner of the taxpayer's bonds, it was entitled to all of the rights of a bondholder, and those rights were not reduced by reason of the fact that it was also the owner of petitioner's stock."

With respect to the commissioners' contention, the Tax Court stated (2 T.C. at p. 158):

> "Respondent's counsel, on brief, makes the rather naive argument that petitioner, after it obtained the

necessary funds for purchase of the taxpayer's bonds on the market, could have loaned these funds to the taxpayer and allowed it to purchase its bonds direct. This is true, and had it voluntarily done so and been content to accept insufficient security for the loan, the taxpayer would have had an increased tax liability as a result in the exact amount of the deficiency here determined. The answer, however, to this argument is that petitioner did not do this. It was free to and did use its funds for its own purposes. It was under no obligation to so arrange its affairs and those of its subsidiary as to result in a maximum tax burden. On the other hand, it had a clear right by such a real transaction to reduce that burden. *Helvering v. Gregory,* 293 U.S. 465; *Chisholm v. Commissioner,* 79 F.2d 14; *Commissioner v. Gilmore Estate,* 130 F.2d 791; *Coca-Cola Co. v. United States,* 47 F. Supp. 109; *Commissioner v. Kolb,* 100 F.2d 920."

Koppers has been acquiesced in by the Commissioner (1943 C.B. 14). Furthermore, it has been cited with approval in a large number of subsequent cases, both by the Tax Court and by the various Circuit Courts, including this court in *Frank v. Int'l. Canadian Corp.,* (9th Cir. 1962) 308 F.2d 520, 530.

Again, the fact that a debt is purchased at a discount by the debtors' wife, and prior thereto the debtor-husband agreed to make a prepayment to her after she acquired it, does not result in a cancellation of the indebtedness. Thus, in *D. Bruce Forrester,* (1945) 4 T.C. 907, (Acq. 1945 C.B. 3), the taxpayer, an individual, owed a corporation $84,152.92. The claim had been valued in a probate proceeding at $28,759.34. Just prior to liquidation of the corporation, the corporation sold the claim to the taxpayers' wife at the appraised price. Shortly after the purchase of the note by the taxpayer's

wife, the taxpayer made a payment on the note to his wife in the amount of $29,000. He had agreed to do this prior to the purchase by the wife even though, under the terms of the note, this payment was not due for a number of years. The husband did not arrange to himself purchase the debt directly from the corporation because of his belief that it would complicate his income tax problems. In holding that the taxpayer did not realize income on the difference between the total amount of the claim and the price paid for it by his wife, the Tax Court said (4 T.C. at p. 921):

> "There is evidence of record to indicate that petitioner was apprehensive of tax liability in 1938 growing out of the disposition by the corporation of its claim against him. Taxpayers are not obliged to so conduct their affairs as to incur or increase their income tax liability, and a transaction may not be disregarded because it resulted from an honest effort to reduce taxes to a minimum. Such designs must be carefully scrutinized, especially where, as here, the taxpayers' wife is concerned, to ascertain whether the transaction is real.
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> "Petitioner did not avoid any liability in the transaction. The result was nothing more, in substance, than a substitution of creditors. If the payee of the note does not pursue all of her remedies for payment of the note upon maturity, it will not be because of her legal inability to do so. Petitioner did not reduce his liability."

With respect to the prepayment which taxpayer made to his wife, the court said (4 T.C. at p. 921):

> "These payments are evidence of good faith."

In *San Jose Pacific Co. Ltd.,* 1939 (P.H.) B.T.A. Memo. Dec. 39-701, Para. 39,412, the members of an affiliated group of corporations acquired the obligations

of one of their wholly-owned subsidiaries at a discount. The group filed consolidated returns, but the debtor-subsidiary was not included in the consolidated returns apparently because it was a public utility company. It was held that the discount did not result in income to the affiliated group.

The situation in the case at bar is far less susceptible to attack than the situations involved in the authorities above discussed. In *Koppers,* the debtor corporation was a wholly owned subsidiary, whereas in the case at bar the corporations were brother-sister corporations with a substantial diversity of stock ownership. In the case at bar the acquisition of the mortgage notes did not contemplate or involve liquidation of the indebtedness, while in *Koppers* at the very time the bonds were acquired at a discount it was admitted that the taxpayer intended to cause its subsidiary to call them for redemption as soon as the acquisition was completed. Not only that, Koppers Co. had an existing intention of immediately liquidating the debtor subsidiary.

In order to finance its acquisition of the bonds, Koppers Co. borrowed $1,500,000 from the subsidiary. Ajax financed the purchase from other sources (Admitted Facts XXVIII, XXIX, R. 93, 94). In *Forrester,* the husband made a substantial prepayment on the principal of the note shortly after the purchase thereof by his wife, pursuant to an agreement made with her prior to the purchase. In the case at bar, appellant taxpayer made a prepayment of $400,000 on the principal of the mortgage notes approximately three months after the purchase by Ajax (Admitted Fact XXIX, R. 93, 94). As an inducement to The Bank of California to make the loan to Ajax, Mr.

Bez had assured the bank that a substantial payment on the principal of the indebtedness would be made by appellant taxpayer to Ajax in the event Ajax was able to purchase the notes (Finding of Fact No. 8, R. 126). In both *Forrester* and the case at bar, it appeared to be for the best interests of the debtor that the notes be acquired by the particular purchaser (Exs. AA, BB). In *Forrester,* the court was of the opinion that this payment by the debtor husband was evidence of good faith. It is axiomatic that the position of a debtor, for better or for worse, is often dependent upon the character of his creditor, and the appellant taxpayer has good reason to assist Ajax by honoring Mr. Bez' commitment to the bank.

It is difficult to imagine a situation where the purchase of an indebtedness at a discount by stockholders of the debtor corporation would escape attribution to the debtor corporation if the purchase involved under the stipulated facts in the case at bar must be attributed to the debtor.

Taxpayers Have a Clear Right to Employ Any Legitimate Method of Conducting Their Affairs to Avoid Incurring a Tax Liability Which Might Have Resulted Had a Different Method Been Adopted.

The important principle set out above is expressed in one way or another in most of the cases discussed in Part I of this brief. However, *Arthur J. Kobacker,* (1962) 37 T.C. 882, Acq. 1964-2 C.B. 6, presents a particularly forceful application. In that case, the taxpayers, who were individuals, wanted to purchase the stock of a corporation, but did not have sufficient funds. Their tax counsel advised against borrowing the necessary balance, since

this would require a declaration of dividends to provide funds to repay the indebtedness and would entail considerable income tax liability.

Consequently, after taxpayers had entered into a contract to purchase the stock, they organized a new corporation and assigned the contract to it. The corporation purchased the stock and borrowed the money to finance the balance of the price. About one year later, the new corporation was merged into the purchased corporation, and the purchased corporation assumed and paid the new corporation's debt.

The commissioner contended that the money borrowed by the new corporation to purchase the stock was in reality a loan to the taxpayers. On this basis, he asserted that the repayment of the loan by the acquired operating company constituted a constructive dividend to the taxpayers. In holding against the commissioner, the Tax Court said at page 895:

> "The method employed was not a sham or subterfuge but one petitioners had a legal right to employ to avoid the *incurrence* of tax liability which might have resulted had they personally borrowed the money, used it to buy the stock of Reiner's, and later caused Reiner's to pay such indebtedness."

Another case which is equally forceful with respect to this principle and provides some significant comparatives to the situation presented by the case at bar is *Ransom W. Chase,* 24 T.C.M. 1054, 1965 P-H T.C. Memo. 65-1153, Para 65,202. In that case, the taxpayer, a closely held corporation, was licensed to manufacture transducers under two sets of patents, one of which was an exclusive license, and the other a non-exclusive license. The patents under which taxpayer had the exclusive license were about

to expire, and taxpayer feared that upon such expiration the owner of the other patents, Curtiss-Wright, would issue licenses to competitors of taxpayer.

For this reason, taxpayer entered into negotiations with Curtiss-Wright to obtain an exclusive license under these patents. Curtiss-Wright refused to grant an exclusive license, but suggested that taxpayer purchase the patents for the fixed sum of $135,000, payable $35,000 down and $25,000 in four subsequent annual installments. Taxpayer's management, for financial reasons, rejected this offer, but proposed to Curtiss-Wright that the shareholders of taxpayer, as a partnership, might be interested in purchasing the patents on the Curtiss-Wright terms. Curtiss-Wright indicated that this was agreeable, but that taxpayer would have to be a party to the agreement and, among other things, guarantee the unpaid balance of the purchase price. Thereupon, the shareholders of taxpayer formed a limited partnership to purchase the patents. The initial cash contribution to the partnership was $35,700, but under the partnership agreement, the partners agreed to contribute an additional $100,000 to the partnership over a four-year period. The percentage of shares owned by the shareholders of taxpayer and the percentage of the partnership interest of the shareholders in the partnership, as to each family group, was substantially the same.

Immediately after the formation of the partnership, Curtiss-Wright assigned the patents to the partnership, and the required three-party agreement was executed between Curtiss-Wright, the partnership and taxpayer.

Thereafter, taxpayer continued to manufacture and sell the transducer devices and paid the partnership a

royalty on all sales of the patented items pursuant to a license agreement between taxpayer and the partnership. The license agreement also granted taxpayer an option to purchase the patents, but this option was never exercised. The balance of the purchase price for the patents was paid by the partnership to Curtiss-Wright in the installments specified in the agreement, and taxpayer was never called upon to pay anything under its guarantee. The patents in question were vitally necessary to taxpayer's business and virtually all of the income of the taxpayer was dependent upon use of the patents.

The court states the commissioners' position as follows (24 T.C.M. at 1068, 1965 P-H T.C. Memo. 65-1168):

> "Nor is respondent taking the position that the series of transactions and agreement which took place herein are unreal and should be disregarded as being a sham. His only contention is that the substance of the series of events should be looked at rather than the form. Once this is done, respondent contends that the only logical conclusion is that Corporation became the owner of the patents. With this we cannot agree.
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>
> "Respondents' entire case is based upon the premise of what he terms a 'tax avoidance scheme.' It is argued by respondent that if Corporation did buy the patents here involved from Curtiss-Wright, there would be no deduction for 'royalty' payments and any payments to the stockholders would be taxable as ordinary dividends. However, the creation of a partnership composed of the principal stockholders of Corporation, which then acquires the patents, gives the double benefit of a deduction to Corporation and capital gains to the partners. It is for this reason that respondent concludes that the substance of the series of transactions culminated in the purchasing of the patents by Corporation. Accordingly, respondent denies recognition to the series of trans-

> actions solely because of the tax benefit derived from the form in which they were cast. Respondent is, in effect, making motive the sole criteria for determining the legitimacy of a transaction. Needless to say, this is an erroneous position."

The court then outlines the legal principles bearing on the commissioners' argument:

> "The legal right of a taxpayer to arrange his affairs so as to decrease the amount of what would otherwise be his taxes or altogether avoid them cannot now be questioned * * * (citing cases) * * * In so arranging his affairs, a taxpayer may choose any form of doing business he desires without being required to adopt the form which results in the greatest tax * * * (citing cases) * * * The tax consequences do not depend upon the motive or purpose in entering into a transaction, * * * (Citing cases) * * * That is to say, a taxpayer's motive to avoid taxation will not establish liability unless the transaction does so regardless of the motive. * * * (citing cases) * * * Therefore, our sole inquiry is not what the purpose or motive of the taxpayer was, but 'whether what is claimed to be is in fact.'"

Having determined that the partnership was the real purchaser of the Curtiss-Wright patents, the court held that the ownership of the patents could not be attributed to the taxpayer. With respect to the vital importance of the patents to the taxpayer, the court said (24 T.C.M. at 1070, 1965 P-H T.C. Memo. 65-1170):

> "True, Corporation's business success depended upon its right to manufacture the articles covered by the Curtiss-Wright patents. While this fact might indicate that Corporation could have purchased the patents and that it may have been reasonable for it to do so, it does not show that Corporation did in fact purchase the patents."

With respect to the commissioners' contentions that the taxpayer could have and should have purchased

the patents itself and that, therefore, taxpayer should be deemed to have done so, the court said (24 T.C.M. at p. 1071, 1965 P-H T.C. Memo. 65-1171):

> "While we do not think the facts support respondents' position, it is not necessary for us to decide this point. Even if we assume respondent is correct, all this requires is a closer scrutiny of the transactions to see whether the substance was in fact any different than the form of the transactions * * * (citing cases) * * * This we have done, and we are satisfied that the form of the transactions was no different than the substance. We are not concerned with why Corporation did not buy the patents but with the question of who did in fact purchase the patents * * * (citing cases) * * *
>
> * * *
>
> "To say that Corporation did purchase the patents because Corporation could have or because it, using hindsight, was cheaper to do so, does not show that Corporation did in fact purchase the patents. We will not recast these transactions because respondent argues an approach which is more advantageous to the revenue."

The *Chase* decision is particularly significant when certain circumstances in that case are compared with the situation in the case at bar. In *Chase,* the taxpayer corporation needed the patents, but couldn't afford to buy them. The partnership formed by the stockholders stepped in and bought them and granted the corporation a license to use them. This arrangement provided substantial tax benefits to all concerned over what would have been the case if the corporation had itself purchased the patents. The commissioner characterized the whole thing as a "tax avoidance scheme." The court points out the fallacy of the commissioner's position in that he is attempting to deny recognition to this series of transactions solely because of the tax benefit derived from

the form in which they were cast. In other words, the commissioner made motive the sole criteria for determining the legitimacy of the transaction. As the Tax Court states:

"Needless to say, this is an erroneous position."

In the case at bar, the relationship of the appellant taxpayer to Ajax is far less intimate than the relationship of the corporation and the partnership in *Chase*. Another important point bearing on the case at bar is emphasized in *Chase*. This is that the fact that the corporation needed the patents and could have purchased them, and that it would have been reasonable for it to do so, does not show that the corporation did, in fact, purchase the patents. The court points out that it will not recast a transaction because the commissioner argues an approach which is more advantageous to the revenue. See also: *Golden State T. & R. Corp. v. Comm'r*, (9th Cir. 1942) 125 F.2d 641; *Guaranty Trust Co. v. U.S.*, (E.D. Wash. 1942) 44 F.Supp. 417, *aff'd*, (9th Cir. 1943) 139 F.2d 69.

If the Corporate Entity of Ajax Were to Be Disregarded, Its Corporate Activities Would Be Attributed to Its Shareholders, Not to Appellant Taxpayer.

As the stipulated facts affirm, Ajax was organized by stockholders of appellant taxpayer, not by appellant taxpayer. Appellant taxpayer had no stock interest in Ajax whatsoever, and its only relationship with Ajax was the identity of the larger part of the stockholders of each corporation. Thus, if the corporate entity of Ajax were to be disregarded, its corporate activities would be attributable only to its stockholders, not to appellant taxpayer. *Comm'r v. Montgomery*, (5th Cir. 1944) 144 F.2d

313. In that case, the taxpayer, who was an individual, had entered into five construction contracts. At a time when the construction under these contracts was partially completed, the contracts were assigned to a newly organized corporation, the stockholders of which were the taxpayers' wife and children. The taxpayer reported and paid a tax on the portion of the profits on these jobs attributable to the work completed prior to the assignment. The profit on the balance of the work was reported by the corporation. The commissioner asserted that the profits on the entire job should be attributable to the taxpayer. In ruling against the commissioner on this issue, the Circuit Court said at page 315:

> "Here, the corporation is owned primarily by stockholders other than Montgomery. It cannot be said that he and it are practically one. If we would attempt to look through the corporation we would mainly see not this taxpayer but his children."

Part II

The Section 269(a)(1) Issue

Section 269(a)(1) Cannot Apply to the Situation Here Involved Because Appellant Taxpayer Did Not Acquire Control of Ajax, Nor Did Ajax Acquire Control of Appellant Taxpayer.

Section 269(a)(1) of the Internal Revenue Code of 1954 (in the form as it existed prior to the 1963 amendment) insofar as claimed by the Government to be applicable[12], provides as follows:

> "Sec. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX
>
> "(a) In General. —If—
>
> (1) any person or persons acquire, or acquired

(12) For the full text of Section 269(a), see Appendix A, page A-2.

on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) * * * *

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation."

This section applies only where a "person or persons" acquire, directly or indirectly, "control of a corporation," *and* the principal purpose for which such acquisition was made is the evasion or avoidance of Federal income tax *by* securing the benefit of a deduction, credit or other allowance which such person or corporation would not *otherwise* enjoy. The term person or persons as used in this section refers to both individuals and corporations (Section 7701(a)(1) I.R.C.). Control is defined as ownership of 50 percent of the voting power or 50 percent of the total value of the shares of the corporation.

The deductions, credits or other allowances which are disallowed by this section may be those of either the acquired corporation or of the acquiring corporation (or individual, as the case may be). *Comm'r v. British Motor Car Distributors, Ltd.*, (9th Cir. 1960) 278 F.2d 392.

However, the section cannot apply to a corporation or individual which is neither the acquired corporation or the acquiring corporation or individual. Thus, in the case at

bar, unless appellant taxpayer is either an acquired corporation or the acquiring corporation, within the meaning of the section, Section 269(a)(1) cannot apply to deductions, credits or other allowances claimed by it.

The stockholders controlling appellant taxpayer also controlled Ajax, but their control of appellant taxpayer was of long standing and was clearly not acquired for any purpose relating to Ajax or the purchase of the mortgage notes. Thus, the control relationship between appellant taxpayer and its own stockholders cannot be the basis for the application of Section 269(a)(1), because the control was not acquired for the purpose proscribed by the section, and this is an essential element to the application of Section 269(a)(1).

The stockholders referred to did acquire control of Ajax in the course of the transactions here involved. However, no deduction, credit or other allowance claimed by Ajax or by said stockholders is challenged.

The only deduction, credit or other allowance which is challenged by the Government is the operating loss deduction claimed by appellant taxpayer.

Thus, unless appellant taxpayer acquired control of Ajax or Ajax acquired control of appellant taxpayer, within the meaning of the section, Section 269 (a)(1) cannot apply to the situation here involved, because acquisition of such control is an essential element to the application of the section.

As previously stated in this brief, Ajax and appellant taxpayer were brother-sister corporations. Neither of them acquired or owned any stock whatsoever in the other. Their only connection with each other was the fact that

the larger part of the stock of each of them was owned by the same stockholders. These stockholders, having been in control of appellant taxpayer for a number of years, acquired control of Ajax in the manner stated in the Statement of Facts herein.

The Government asserts that this must be construed as the acquisition, indirectly, of control of Ajax by appellant taxpayer. However, it is obvious that the mere fact that two corporations are controlled by the same stockholders does not place one of them in control of the other, directly or indirectly, except in cases where attribution statutes expressly require that assumption for certain limited purposes. There is no attribution statute which applies to Section 269. The attribution rules of Section 318 are not applicable to Section 269, since they apply only to subchapter C of the Code, and Section 269 is the subchapter B. *Brick Milling Co.*, 22 T.C.M. 1603, P-H T.C. Memo, Para. 63,305.

In *Brick Milling Co.*, one of the issues was when control of a corporation was acquired within the meaning of Section 269(a)(1). Two brothers owned the controlling stock of corporation A and corporation B. On October 23, 1957, they transferred the controlling stock of corporation B to corporation A. Due to the common ownership of the stock of the two corporations by the same stockholders, it was argued that corporation B was already controlled by corporation A and, thus, corporation A did not acquire control by the receipt of the B stock. The Tax Court held that common ownership of stock by the same stockholders does not vest control of either corporation in the other within the meaning of Section 269(a)(1). In this connection, the court says (22 T.C.M. 1610):

> " ° ° ° the attribution rules of Section 318 are inapplicable since they apply only to subchapter C of the 1954 Code, and Section 269 is in subchapter B. The Petitioner has pointed to no provisions of the Code that would attribute ownership of Sanitary stock to it so as to justify the holding that Brick Milling Company controlled Sanitary Ice prior to the time it acquired the Brick brothers' shares in 1957."

See also Mertens, *Federal Income Taxation,* (1967 rev.) §38.66, at p. 196; and *Thomas E. Snyder & Sons Co. v. Comm'r,* (7th Cir. 1961) 288 F.2d 36, applying the same rule to Section 129 of the 1939 Code.

That the acquisition of control is essential to the application of Section 269(a)(1) is established by the decision of this court in *Maxwell Hardware Co. v. Comm'r,* (9th Cir. 1965), 343 F.2d 713. In that case, Maxwell Hardware had sustained losses of $1,000,000 in the hardware business. It entered into an agreement with two partners (who theretofore had no interest in Maxwell) who were engaged in numerous real estate development activities, whereby a real estate department was established by Maxwell to develop a subdivision. The funds to finance the real estate venture were furnished by the two partners through the purchase of nonvoting preferred stock for an amount equal to about two-fifths of the value of Maxwell's common stock.

The agreement provided that the real estate venture would be continued for six years, that the partners would not sell their stock during that period, and that if the real estate department were discontinued after six years, the preferred stock would be redeemed by distribution in kind of 90 percent of the departments' assets to the preferred stockholders. A voting trust was established

to restrict the control of the common stockholders for a period of five years. The voting trust agreement appointed a bank as voting trustee with unfettered authority to vote the common stock, except that it was bound to vote for two specified individuals (a bank officer and one of the common stockholders) as two of the three directors. Although the bank was unrestricted as to the third director, it was understood that one of the partners (Federighi) would be the third director. The hardware business was discontinued and the real estate business was operated at a profit.

The Tax Court found as a fact, and this court affirmed, that the primary purpose of the partners in making the deal was to offset the anticipated profits of the real estate venture against the prior losses of the hardware business.

This court points out, however, that Section 269 requires more than a proof of purpose to avoid taxes. In this connection this court says, at page 720:

> "The additional requirement is the acquisition directly or indirectly of control of a corporation, specifically, the ownership of stock possessing at least fifty percent of the voting power or at least fifty percent of the total value of shares of all classes."

With respect to the commissioners' argument that the partners acquired control indirectly through the voting trust agreement, this court said at page 721:

> "Such evidence, however, does not, in our view, justify an inference, as the Government asserts, that fifty percent voting control was thereby acquired by Beckett and Federighi. A voting trust agreement is too valuable a vehicle for the effectuation of innumerable commercial transactions to be thus

lightly impugned; and the eagerness of the commissioner to collect taxes, a duty imposed on him by law, should not lead the courts arbitrarily to disregard established and useful forms of business relationships."

Having disposed of the specific points of law raised in the case, this court then lays down a statement of policy which we feel compelled to quote (p. 723):

"Taxation is peculiarly a matter of statutory law, and in applying that law to the determination and computation of income and deductions, the courts do not make moral judgments. There is nothing perfidious or invidious in enjoying a statutory deduction from reportable income. It is not a matter of conscience but of statue and the determination of Congressional intent. In our opinion, Congress has quite plainly said that net operating loss deductions should be allowed unless the special circumstances interpreted within the letter and spirit of Sections 382(a) and 269 obtain. The conditions disallowing the deduction have not been established here. It is of much more importance that businessmen, accountants, lawyers and revenue agents should retain confidence that plain statutory language means what it says and what it reasonably implies than that a particular deficiency assessment should be sustained."

Appellant Taxpayer Did Not Secure the Benefit of a Deduction, Credit or Other Allowance Which It Would Not Otherwise Have Enjoyed.

In addition to the complete bar to the application of Section 269(a)(1) resulting from lack of control of Ajax by appellant taxpayer, the fact the appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed, is a second, independent bar to the application of Section 269(a)(1).

The tax avoidance attributed to appellant taxpayer in the case at bar is based on its determination not to purchase the mortgage notes. If it had purchased them, it would have realized additional income from cancellation of indebtedness and thus would have sustained additional income tax liability for the year ended March 31, 1957. By electing not to purchase the notes, this additional tax liability was simply not incurred. No deduction, credit or other allowance was involved. The purchase of the notes by Ajax did not secure to appellant taxpayer any such deduction, credit or other allowance.

However, the Government points to appellant taxpayers' operating loss deduction, asserting that this is indeed a deduction and may therefore fall within the ambit of Section 269(a)(1). In order to analyze this assertion, it must be recalled that the operating loss deduction arose from operating losses incurred by appellant taxpayer in years other than the year ended March 31, 1957 (ex. A-1). As previously stated, these operating losses have been claimed as deductions for appellant taxpayers' taxable years ended March 31, 1960, and March 31, 1961, and it is conceded that they are available as deductions in those years unless they are consumed and thus exhausted by the additional taxable income which the Government asserts appellant taxpayer has incurred from cancellation of indebtedness in the year ended March 31, 1957 (Ex. A-1, Stipulation No. IV, R. 104). It thus becomes apparent that the Government is not really attempting to deprive appellant taxpayer of the benefit of this operating loss deduction. On the contrary, it is asserting that the benefit of this deduction is to be enjoyed in the year ended March 31,

1957, rather than in the later years as claimed by appellant taxpayer. If appellant taxpayer in fact realized additional taxable income in the year ended March 31, 1957, the operating loss deduction is properly applicable against that income, and the taxpayer receives the full benefit of the deduction. If appellant taxpayer did not realize the additional taxable income in the year ended March 31, 1957, the operating loss deduction is not consumed and remains available for application against the taxable income in subsequent years. In neither case is the appellant taxpayer deprived of enjoying the benefit of a single dollar of the deduction.

This is a vastly different situation from the case where a taxpayer, having already accrued a sizable operating loss deduction and having no foreseeable way of utilizing it, enters into a transaction whereby he will be able to enjoy the benefit of such deduction that would not otherwise be available to him.

To the extent that appellant taxpayer had an intent to avoid taxes, it was to avoid *paying* a ruinous tax for its year ended March 31, 1957. Section 269(a)(1), has no bearing on the taxpayers' purpose to avoid incurring additional tax. *John F. Nutt,* (1962) 39 T.C. 231, *aff'd on another point, Nutt v. Comm'r,* (9th Cir. 1965) 351 F.2d 452.

In *Nutt,* the taxpayer, who had been a farmer since 1935, formed a corporation in 1955 and transferred to it a portion of his farmlands including a mature, but unharvested, cotton crop thereon for a consideration of $324,933, the larger part of which represented the value of the unharvested cotton. Later in the same year, he organized a second corporation to which he transferred

certain farm leases, also including mature, but unharvested, cotton crops for a consideration of $97,856, the larger part of which also represented the value of the unharvested cotton. The taxpayer continued to operate the farms as an officer of the corporations much in the same manner as he had previously done as an individual. The commissioner contended, among other things, that the farm income should be allocated to the taxpayer under Section 269(a)(1). In rejecting this argument, the Tax Court said at page 250:

> "Respondent has not disallowed to petitioners any deduction, credit or other allowance but has rather increased both the income and deductions claimed by petitioners on their returns. Since respondent has not attempted to disallow to petitioners a deduction, credit, or other allowance claimed by them, Section Section 269 of the Internal Revenue Code of 1954 is by its terms inapplicable."

Furthermore, in the case at bar, appellant taxpayers' stockholders had an equally legitimate alternative open to them. They or a group of them could have bought the mortgage notes individually in which case Section 269(a)(1) could not have had any possible application. Where various alternatives are thus available, the selection of one of them does not result in obtaining a benefit which would not otherwise have been enjoyed. *Cromwell Corp.*, (1964) 43 T.C. 313.

In *Cromwell*, four individuals desired to acquire corporation A (Cornwell). To this end, they formed corporation B (Cromwell), which obtained a temporary loan of $400,000 from a bank secured by corporation A's assets and guaranteed by the individuals. With the proceeds of this loan corporation B acquired all of the cor-

poration A stock. After the acquisition, corporation A obtained a new $400,000 bank loan, secured again by A's assets and guaranteed by the individuals. Corporation A then paid a $400,000 dividend to corporation B, and B paid off its temporary bank loan. B and A filed a consolidated return for the year involved, thus eliminating the dividend from their consolidated net income.

It was pointed out that the purchasers could have purchased the assets rather than the stock of corporation A, in which case they could have used the assets as collateral for the bank loan, and Section 269(a)(1) would not have had any possible application.

Nevertheless, the commissioner disallowed to the corporations the privilege of filing a consolidated return on authority of Section 269(a)(1) and contended that corporation B was taxable on the $400,000 dividend. The court said at page 317:

> "We rest our decision upon the ground that, irrespective of purpose, there has been no securing of a benefit which would not otherwise have been enjoyed."

The commissioner argued (as did the Government in the case at bar) that corporation B would not have been formed but for the apparent opportunity to finance the acquisition of corporation A by withdrawing its accumulated earnings without incurring the tax which would have resulted if the principals has purchased the stock and received the dividends themselves. With respect to this contention, the court said at page 322:

> "Section 269 refers to securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy. It does not use a

'but for' test of whether or not the taxpayer would secure the same benefit if the questioned 'deduction, credit, or other allowance were eliminated from the transactions. Certainly if the only change in the transactions were that Cromwell was never formed, the principals would be liable for a tax on the dividend paid to them as shareholders of Cornwell. However, it is utterly implausible that the principals would have chosen to follow such a course in acquiring Cornwell. Rather, they would have employed one of the alternative methods discussed above. We are persuaded that such alternatives were completely feasible and since the benefits sought herein would have been enjoyed, Section 269, by its very terms, is inapplicable."

CONCLUSION

It is respectfully submitted that for the foregoing reasons, and on the authorities cited, (1) appellant taxpayer did not realize taxable income from cancellation of indebtedness in its taxable year ended March 31, 1957, as a result of the transactions which are the subject of this proceeding, and (2) that Section 269(a) of the Internal Revenue Code of 1954 does not apply to the transactions which are the subject of this proceeding, and the net operating loss deductions claimed by appellant taxpayer for its taxable years ended March 31, 1960, and March 31, 1961, are not disallowed by said section; and that the judgment of the trial court should be reversed with directions to enter judgment in favor of appellant taxpayer accordingly.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

WILLIAM R. SMITH
Of Attorneys for Appellant

APPENDIX A

Section 61(a) of the Internal Revenue Code of 1954

SEC. 61. GROSS INCOME DEFINED.

(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

Section 269(a) of the Internal Revenue Code of 1954 (Prior to 1963 Amendment)

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) IN GENERAL.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

APPENDIX B

Table of Exhibits and Depositions

Exhibits

The following exhibits (except Exhibit 00) were identified and offered in evidence at the trial of this case by appellant and appellee jointly, and received in evidence without objection. Exhibits A through NN were identified, offered and admitted in accordance with Paragraph 7 of the Pre-Trial Order (R. 105). Exhibit 00 was identified and offered by appellee and admitted without objection (Tr. 89).

Exhibit	*Description*	*Record Transcript of Proceedings*
A-1	Notice of Deficiency (90-day letter) dated December 20, 1963, from the Commissioner of Internal Revenue to appellant taxpayer for the taxable years ended March 31, 1960, and March 31, 1961	Tr. 20
A-2	List, as of January 30, 1957, of beneficiaries under Trust Agreement dated June 27, 1950, between Sarah Harris Johnson and Seattle-First National Bank for the benefit of the former shareholders of P. E. Harris & Co.	Tr. 20
B	Minutes of Special Meeting of Board of Directors of The Ajax Company held January 30, 1957, with attachments	Tr. 20
C	Minutes of Special Meeting of the Board of Directors of The Ajax Company held February 21, 1957	Tr. 20
D	Power of Attorney dated July, 1956, from Thos. J. Bannan to Mr. Nick Bez and Mr. G. Hamilton Beasley	Tr. 20

Exhibit	*Description*	*Record Transcript of Proceedings*
E	Escrow instructions dated February 1, 1957, from The Ajax Company to the Trust Department of the Bank of California, N.A.	Tr. 20
F	Letter dated February 21, 1957, from The Ajax Company to The Bank of California, N.A.	Tr. 20
G	Letter dated February 21, 1957, from The Ajax Company to The Bank of California, N.A.	Tr. 20
H	Letter dated February 21, 1957, from The Ajax Company to Seattle-First National Bank	Tr. 20
I	Document entitled "Transfer of Assets Upon Distribution of Trust" dated February 21, 1957, with Schedule "A" attached, executed by Seattle-First National Bank, Trustee	Tr. 20
J	Document entitled "Assignment" dated February 21, 1957, with Schedule "A" attached, executed by The Ajax Company, Assignor	Tr. 20
K	Receipt dated February 21, 1957, issued by The Bank of California, N.A., to The Ajax Company	Tr. 20
L	Letter dated July 12, 1957, to The Bank of California, N.A., from Graham, Green & Dunn, Attorneys at Law, 625 Henry Building, Seattle 1, Washington, executed by Mr. James Wm. Johnston, containing a Receipt dated July 15, 1957, executed by The Bank of California, N.A.	Tr. 20
M	Promissory Note dated February 20, 1957, executed by The Ajax Company	Tr. 20
N	Letter dated March 20, 1957, from The Ajax Company to William R. Staats Com-	

Exhibit	*Description*	*Record Transcript of Proceedings*
	pany, containing a Receipt, dated March 27, 1957, executed by William R. Staats Company	Tr. 20
O	Undated letter from The Ajax Company to The Bank of California, N.A.	Tr. 20
P	Promissory Notes dated May 23, 1957, and October 2, 1957, respectively, executed by The Ajax Company and payable to the order of The Bank of California, N.A., in the sum of $192,000.00	Tr. 20
Q	Bills Receivable ledger of The Bank of California, N.A., maintained with respect to The Ajax Company	Tr. 20
R	List of stockholders of The Ajax Company, February 21, 1957	Tr. 20
S	List of stockholders of P. E. Harris Company, Inc., February 21, 1957	Tr. 20
T	Agreement dated June 11, 1957, by and between Seattle-First National Bank and The Ajax Company	Tr. 20
U	Standby Agreement dated April 21, 1958, executed by The Ajax Company and P. E. Harris Company, Inc., to Seattle-First National Bank	Tr. 20
V	Minutes of Annual Meeting of Stockholders of The Ajax Company held May 17, 1957	Tr. 20
W	Minutes of Annual Meeting of Board of Directors of The Ajax Company held May 17, 1957	Tr. 20
X	Minutes of Special Meeting of Board of Directors of The Ajax Company held January 31, 1958	Tr. 20
Y	Minutes of Annual Meeting of Stockholders of The Ajax Company held May 29, 1958	Tr. 20

Exhibit	*Description*	*Record Transcript of Proceedings*
Z	Minutes of Annual Meeting of Board of Directors of The Ajax Company held May 29, 1958	Tr. 20
AA	Minutes of Annual Stockholders Meeting of P. E. Harris Company, Inc., held May 17, 1957	Tr. 20
BB	Minutes of Annual Meeting of Board of Directors of P. E. Harris Company, Inc., held May 17, 1957	Tr. 20
CC	Minutes of Special Meeting of Board of Directors of P. E. Harris Company, Inc., held December 10, 1958	Tr. 20
DD	Minutes of Adjourned Special Meeting of Board of Directors of P. E. Harris Company, Inc., held January 14, 1959	Tr. 20
EE	Copies of letters dated January 16, 1959, from Nick Bez to Donald Royce, Fred R. Tuerk, Thos. J. Bannan, Jacques Bergues and George Darneille	Tr. 20
FF	Document entitled "Option" dated January, 1959, in favor of Nick Bez, covering common stock and promissory notes of P. E. Harris Company, Inc.	Tr. 20
GG	Letter dated March 6, 1959, from Nick Bez, The Ajax Company, P. E. Harris Company, Inc., and Peninsula Packers, to Seattle-First National Bank; List of P. E. Harris Company, Inc., stock and notes dated 3/31/50, covered by options to Nick Bez; List of The Ajax Company stock and notes dated 2/20/57, covered by options to Nick Bez; Letter of transmittal and instructions to Seattle-First National Bank; Assignment of P. E. Harris Company, Inc., stock to The Ajax Company; Assignment of P. E. Harris Company, Inc., Non-Negotiable Promis-	

Exhibit	*Description*	*Record Transcript of Proceedings*
	sory Notes to P. E. Harris Company, Inc.; Assignment of The Ajax Company stock to Nick Bez dated March, 1959; and Assignment of The Ajax Company Non-Negotiable Promissory Notes to The Ajax Company, dated March, 1959	Tr. 20
HH	Document entitled "Amendment to Partnership Agreement" dated March 4, 1959, between Calvert Corporation and Trans-Pacific Fishing & Packing Company, as partners doing business as Peninsula Packers	Tr. 20
II	Minutes of Special Stockholders Meeting of The Ajax Company held March 25, 1959	Tr. 20
JJ	Minutes of Special Meeting of Board of Directors of The Ajax Company held March 25, 1959	Tr. 20
KK	Minutes of Special Meeting of Board of Directors of The Ajax Company held June 29, 1959	Tr. 20
LL	Letter dated June 29, 1959, from The Ajax Company to The Bank of California, N.A., approved and accepted by The Bank of California, N.A. on June 29, 1959	Tr. 20
MM	Letter dated June 30, 1959, from The Ajax Company to P. E. Harris Company, Inc.	Tr. 20
NN	Document entitled "Complaint" in the Superior Court of the State of Washington for King County, No. 493805, with attachments	Tr. 20
OO	Memorandum re P. E. Harris Company, Inc., dated June 5, 1956	Tr. 86, 89
PP	Agreement dated March 23, 1950, between P. E. Harris & Co. and P. E. Harris Company, Inc.	Tr. 159, 160

Exhibit	*Description*	*Record Transcript of Proceedings*
QQ	Promissory note dated March 31, 1950, executed by P. E. Harris Company, Inc., and payable to P. E. Harris & Co. in the sum of $1,350,000.00	Tr. 159, 160
RR	Promissory note dated March 31, 1950, executed by P. E. Harris Company, Inc., and payable to P. E. Harris & Co. in the sum of $318,432.00	Tr. 159, 160
SS	List of Stockholders and unsecured note holders of P. E. Harris Company and The Ajax Company as of February 21, 1957	Tr. 162, 163
TT	Financial statement of P. E. Harris Company, Inc., for the year ended March 31, 1957	Tr. 25 (2-10-67)
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No. 22,352

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PETER PAN SEAFOODS, INC.,
a Washington corporation,

Plaintiff-Appellant

v.

UNITED STATES OF AMERICA,

Defendant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

BRIEF FOR THE APPELLEE

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
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No. 22,352

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

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Defendant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

BRIEF FOR THE APPELLEE

STATEMENT OF THE ISSUES PRESENTED

1. Whether the District Court erred in finding that mortgage notes issued by the taxpayer-corporation were in substance (as distinguished from form) purchased by the corporation at a discount and that the corporation accordingly realized taxable income, through a cancellation of indebtedness, under Section 61(a)(12) of the Internal Revenue Code of 1954 during its 1957 fiscal year (from which it follows that

the corporation is not entitled to claimed net operating loss carry-forward deductions for its 1960 and 1961 fiscal years).

2. Whether the District Court erred in holding that the net operating loss carry-forward deductions claimed by the taxpayer are also disallowable under Section 269(a) of the Internal Revenue Code of 1954 (relating to acquisitions made to evade or avoid income tax).

STATEMENT OF THE CASE

This appeal involves federal income taxes for the fiscal years ending March 31, 1960, and March 31, 1961. After the Commissioner determined deficiencies in income tax for those years in the amounts of $114,980 and $121,737 respectively (I-R. 11-14, 43-46, 85), the taxpayer paid the deficiencies on July 7, 1964 (I-R. 85), filed claims for refund on July 16, 1964 (I-R. 10, 42), and on February 17, 1965, within the time provided in Section 6532 of the Internal Revenue Code of 1954, instituted this suit in the District Court for recovery of the alleged overpayments in taxes (I-R. 1-9). The District Court filed a memorandum decision (I-R. 109-123), which is reported at 272 F. Supp. 888. Judgment was entered on August 7, 1967, dismissing the complaint. (I-R. 128.) On October 4, 1967, within 60 days thereafter, a notice of appeal was filed. (I-R.

129.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

The facts as found by the District Court (I-R. 124-127) were drawn largely from facts admitted in the pretrial order (see I-R. 111-112),[1] and may be restated as follows:

The taxpayer, now named Peter Pan Seafoods, Inc., is the successor to P. E. Harris Company, Inc. (referred to by the District Court as "New Harris" and hereinafter as the "taxpayer"), which in turn was the successor to P. E. Harris Company (hereinafter referred to as "Old Harris"), a liquidated corporation. (I-R. 124.)

The taxpayer seeks to recover income taxes and interest in the total amount of $286,886.26 which are alleged to have been erroneously assessed and collected by the Commissioner of Internal Revenue for the taxable years ended March 31, 1960, and March 31, 1961. The disputed transactions before the Court with respect to which the Commissioner determined tax deficiencies occurred during the tax year ended March 31, 1957. The deficiencies for the taxable years are caused by the recomputation of the net operating loss carry-forwards to those years as a result of the defi-

[1] For the admitted facts stated in the pretrial order, see I-R. 84-103.

ciency for the tax year ended March 31, 1957. (I-R. 125.)

On March 23, 1950, the taxpayer executed two mortgage notes in the total amount of $1,668,432 for the purchase of Old Harris, then in the process of liquidation. The notes were transferred to the Seattle First National Bank as trustee, which issued certificates of beneficial interest to the 68 former stockholders of Old Harris as beneficiaries. On December 31, 1954, the maturity date of the smaller note and interest on both notes were extended by the Seattle bank. (I-R. 125.)

During 1956, it appeared the mortgage notes of the taxpayer might be purchased at a substantial discount. Nick Bez, president and a major stockholder in the taxpayer, was interested in the acquisition of the two notes by the taxpayer. However, Bez was advised that acquisition by the taxpayer of its own indebtedness at a discount would result in the realization of taxable income in an amount equal to the discount. Bez concluded it would not be feasible for the taxpayer to acquire its two mortgage notes. (I-R. 125.)

On May 21, 1956, Bez and G. Hamilton Beasley, another officer and stockholder in the taxpayer, caused The Ajax Company (hereinafter referred to as "Ajax") to be organized for the purpose of attempt-

ing to purchase the taxpayer's mortgage notes. Bez and Beasley then solicited stockholders of the taxpayer for pro rata contributions and the large majority (85.44 per cent) of taxpayer's stockholders committed themselves to the purchase of Ajax stock and five-year notes, in the total amount of $142,228.52. (I-R. 125.)

Although clear control of the taxpayer was not held by any group or individual, no stockholder influential in the taxpayer, either by virtue of an executive office or because of substantial stock ownership, declined to participate in the formation of Ajax. Bez, personally and through his wholly owned corporation, Trans-Pacific Fishing and Packing, and its related interest in the partnership of Peninsula Packers, controlled the largest single amount of stock in both the taxpayer and Ajax. Beasley was president of Ajax and the largest individual stockholder in the taxpayer. He also was executive vice-president of West Coast Airlines of which Bez was president, and devoted his full time to the airline, the taxpayer and other enterprises in which Bez was interested. (I-R. 125-126.)

On February 21, 1957, the aggregate purchase price paid by Ajax for the taxpayer's mortgage notes was $774,288. The total amount of the taxpayer's indebtedness was then $1,861,514, including accrued interest. The Bank of California loaned Ajax $642,000

and this amount was combined with the $142,228 raised by soliciting stockholders in the taxpayer. Ajax pleged the taxpayer's mortgage notes as security for the loan. (I-R. 126.)

The Seattle First National Bank had previously refused to loan Ajax the additional amount necessary for the purchase of the taxpayer's notes without first receiving the personal guarantee of Bez. The Bank of California agreed to make the loan but conditioned it upon a promise by Bez that a substantial payment on the indebtedness would be made in the near future. On May 17, 1957, the taxpayer paid Ajax $66,737.38 as interest for the year ended March 31, 1957, and thereupon Ajax paid $60,000 to the Bank of California. On May 23, 1957, the taxpayer made a prepayment on the principal of the two mortgage notes to Ajax in the amount of $400,000; on the same day Ajax reduced its indebtedness to the Bank of California by $399,667 ($390,000 principal and $9,667 accrued interest). Thus, by May 23, 1957, and within three months and two days from the time it was incurred, Ajax had reduced its principal indebtedness to the Bank of California from $642,000 to $192,000 by utilizing funds supplied exclusively by the taxpayer and its stockholders. (I-R. 126.)

From the date of its incorporation until it ac-

quired all of the taxpayer's stock on March 25, 1959,[2] Ajax did not engage in any business activity other than to negotiate the purchase of the notes in question. During the same period Ajax had no assets other than the taxpayer's mortgage notes and a small amount of cash. (I-R. 126.)

The primary, dominant and moving purpose for the formation of Ajax was to avoid federal income tax on the purchase of the taxpayer's indebtedness at a discount. (I-R. 127.)

Upon the basis of the foregoing findings the District Court concluded that the notes here involved were in substance purchased by the taxpayer and should be so treated for purposes of determining its tax liability; that the net operating loss deductions claimed by the taxpayer should be disallowed; and that the taxpayer is precluded from recovering the tax refund it seeks in this action "under either or both of Sections 61(a)(12) and 269(a) of the Internal Revenue Code of 1954." (I-R. 122-123, 127.)

---

[2] In 1959, through a series of rather involved transactions, Ajax became the sole stockholder of the taxpayer, the notes in issue were contributed to the taxpayer's capital, and stock of the taxpayer was substituted as collateral for Ajax' remaining indebtedness to the Bank of California, N. A. (See Admitted Facts, I-R. 96-101; Exs. JJ, KK, LL, MM.)

SUMMARY OF ARGUMENT

I

The District Court correctly held that mortgage notes issued by the taxpayer-corporation were in substance (as distinguished from form) purchased by the corporation at a discount, and that the corporation accordingly realized income in the amount of the discount under Section 61(a)(12) of the Internal Revenue Code of 1954 during its 1957 fiscal year (thus absorbing claimed net operating losses which taxpayer seeks to carry forward to its 1960 and 1961 fiscal years). It is true that the notes were purchased by Ajax, another corporation, which was formed by taxpayer's major stockholders for the sole purpose of buying the notes. Ajax was concededly formed to avoid the tax which would result from purchase of the notes by taxpayer. Ajax transacted no business except to purchase the notes during the period in question, and it would have been dissolved if it had not been able to purchase them. Ajax had no choice or discretion as to the purchase of the notes; and the funds and credit required for the purchase were supplied by the taxpayer in major part, the balance of the funds being put up by taxpayer's controlling stockholders. The District Court specifically found that tax avoidance was the primary, dominant and moving purpose for the

formation of Ajax; and, looking through form to substance, the District Court held that the purchase of the notes should be attributed to the taxpayer for the purposes of Section 61(a)(12) of the Code since Ajax was merely a conduit or instrument by means of which taxpayer sought to escape from the impact of that section.

We submit that the District Court made no error. There is virtually no dispute as to the facts, and while taxpayer is correct in asserting that taxpayers have the right to decrease or avoid their taxes by means which the law permits, nevertheless, the fact that a transaction was entered into for tax avoidance purposes and not for any legitimate commercial or industrial purpose is certainly not without significance in determining the applicability of a statute which contemplates a commercial or industrial transaction. Escaping taxation is not a business transaction within the meaning of the revenue laws. If it were, then the long-established rule as to looking through form to substance would be deprived of vitality and the Government would be at the mercy of taxpayers who could effectively employ formalisms devoid of substance in order to escape taxation. In the instant case, Ajax was nothing but a conduit, agent, alter ego, tool, instrumentality or puppet by which taxpayer sought to draw in its notes at a discount without accounting for the income which such a transaction normally gener-

ates. It cannot lightly be presumed that Congress intended to permit the command of the statute (Section 61(a)(12) of the Code) to be disregarded through such a flimsy expedient. Such an attempted disguise should not be allowed to obscure the substance of the transaction in the instant case; and the District Court had ample warrant to hold as it did that the purchase of the notes should be treated for tax purposes as having been made by the taxpayer.

II

The District Court held that Section 269(a) of the 1954 Internal Revenue Code is also applicable in the instant case and constitutes an additional ground for the denial of the taxpayer's claims for refund. We submit that that holding is correct.

Section 269(a) provides that if any person or persons acquire, directly or indirectly, control of a corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of federal income tax by securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. The statute further provides that control means at least 50 percent

of the voting power or value of all stock in the acquired corporation.

In the instant case, there is no question as to the existence of the tax avoidance purpose, and it is conceded. There is likewise no question but that stockholders of taxpayer owning over 50 percent of its stock acquired more than 50 percent of the stock of Ajax. It further appears that all of the directors of Ajax were also directors of taxpayer. It follows that the controlling stockholders of taxpayer had direct control of Ajax, and taxpayer itself had indirect control of Ajax for all practical purposes.

It is clear that the acquisition of Ajax was designed to secure the benefit of a deduction, credit or other allowance which the taxpayer and its stockholders would not otherwise enjoy, since the hoped-for tax benefits would include the net operating loss deductions which would be available as carryovers to 1960 and 1961 if not absorbed by income for 1957. The tax attributes of the formation and activity of Ajax directly affect the calculation of taxpayer's income for 1957, and in turn determine whether the carryovers claimed by taxpayer are allowable as deductions in 1960 and 1961. Thus the benefit of the carryovers (if allowable) would accrue to both the taxpayer and its stockholders, and they were persons who stood to pro-

fit taxwise through the organization of Ajax and the purchase by it of the taxpayer's notes. Not only taxpayer, but its stockholders as well, had a definite beneficial interest in obtaining the tax deductions which would flow from the purchase of the notes by Ajax if the form of the transaction were permitted to override its substance and effect. The very purpose of the arrangement was to enable the taxpayer to enjoy an accession to income which would not only be nontaxable but would serve to create a fictitious addition to its net operating losses; if successful, the scheme would avoid any realization of income by taxpayer from the 1957 purchase and would consequently preclude the absorption of the carryovers to 1960 and 1961 which are claimed by the taxpayer as operating loss deductions. Thus taxpayer (and its stockholders) are seeking a tax benefit through the acquisition of Ajax which would not otherwise be enjoyed.

We respectively submit that the District Court's decision is correct in all respects and should therefore be affirmed by this Court.

ARGUMENT

I

THE DISTRICT COURT CORRECTLY HELD THAT TAXPAYER IN SUBSTANCE ACQUIRED ITS OWN INDEBTEDNESS AT A DISCOUNT IN 1957 AND THEREBY REALIZED INCOME IN THE AMOUNT OF THE DISCOUNT UNDER SECTION 61(a)(12) OF THE 1954 INTERNAL REVENUE CODE

There is no question but that the purchase by taxpayer of its two mortgage notes at a discount would constitute taxable income to taxpayer in the amount of the discount. Section 61(a)(12) of the Internal Revenue Code of 1954, Appendix A, *infra; United States* v. *Kirby Lumber Co.*, 284 U.S. 1; 2 Mertens, Law of Federal Income Taxation (1967 Rev.), Section 11.19. The purchase of these two notes by Ajax was in substance a purchase by taxpayer and consequently taxpayer realized taxable income in the ahount of the discount for the fiscal year ended March 31, 1957. The statute of limitations has run on 1957 but a portion of the 1957 income affects the taxable income for the years here involved (fiscal years ended March 31, 1960 and 1961) by eliminating net operating losses which were carried forward to those years by the taxpayer. The disallowance of such net operating loss deductions in the fiscal years ended March 31, 1960 and 1961, is the basis for the deficiencies in

this case. (I-R. 13, 45, 125.) It is undisputed that income for a year closed by the statute of limitations may be adjusted in the determination of the propriety of a net operating loss to be carried forward to an open year. *Vita-Food Corp.* v. *Commissioner*, 238 F. 2d 359 (C.A. 9th); *Phoenix Coal Co.* v. *Commissioner*, 231 F. 2d 420 (C.A. 2d).

It is an established rule that substance must prevail over form in determining the true nature of a transaction for income tax purposes; and that rule has been applied in numerous cases under varying circumstances and statutory provisions. *Eisner* v. *Macomber*, 252 U.S. 189; *United States* v. *Phellis*, 257 U.S. 156; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331; *United States* v. *Lynch*, 192 F. 2d 718 (C.A. 9th), certiorari denied, 343 U.S. 934. Thus, in the *Court Holding Co.* case the Supreme Court said (324 U.S. p. 334):

> The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be dis-

> guised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

While that case was concerned with determining who was the real seller of property, and the instant case is concerned with determining who was the real purchaser of the notes, the basic principles enunciated above are equally applicable here. See also *Gregory* v. *Helvering*, 293 U.S. 465; *Minnesota Tea Co.* v. *Helvering*, 302 U.S. 609; *Griffiths* v. *Commissioner*, 308 U.S. 355; *Higgins* v. *Smith*, 308 U.S. 473; *Bazley* v. *Commissioner*, 331 U.S. 737; *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451.

In *United States* v. *Lynch*, *supra*, this Court, in applying the rule as to looking through form to substance, stressed the proposition that in construing tax statutes, which describe commercial or industrial transactions, the statutory words should be deemed to refer to transactions entered upon for commercial or industrial purposes, and not to include transactions entered upon for no other motive but to escape taxation. Of course, this does not mean that no transaction entered into for tax purposes can ever be recognized under the income tax statutes. As was said in *Gregory* v. *Helvering*, *supra*, 293 U.S. p. 469: "The legal right of a taxpayer to decrease the amount of what would otherwise be his taxes, or altogether avoid them, by means

which the law permits, cannot be doubted *** But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended." Thus, the fact that a transaction was entered into solely for tax avoidance purposes and not for any legitimate commercial or industrial purpose is certainly not without relevance in determining the applicability of a statute which contemplates a commercial or industrial transaction, since escaping taxation is not such a transaction in the ordinary sense of that term. *National Investors Corp.* v. *Hoey*, 144 F. 2d 466 (C.A. 2d), approved in *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 434 (fn. 20). The words of the statute we are dealing with here (Section 61(a)(12) of the 1954 Code) should be given their "plain popular meaning" (*United States* v. *Kirby*, *supra*, 284 U.S. p. 3); and given that meaning, they obviously contemplate a commercial or industrial transaction. Hence, they require that the purchase of the notes here involved be attributed to the taxpayer even though such purchase was not made directly by the taxpayer but was made by it indirectly through Ajax in the hope of avoiding taxation. In the circumstances it would defeat the Congressional purpose to hold that the impact of the statute could be nullified by an agreement entered upon for no other motive but to escape taxation.

It is true that the District Court in the instant case found that escaping taxation was not the sole motive for the formation of Ajax and its purchase of the taxpayer's notes; but the District Court also found that the alleged business motives (profit incentive and keeping the notes in friendly hands) did not have "any significant or material motivating influence in causing the formation of Ajax and its purchase of the New Harris notes." (I-R. 118.) The District Court has determined in its careful opinion (I-R. 117, 127) that "tax avoidance was the primary, dominant and moving purpose for the formation of Ajax and for its single business activity in purchasing the New Harris indebtedness." The District Court has also found (I-R. 114, 116, 117, 126) that from the date of its incorporation until it acquired all stock of New Harris (taxpayer) on March 25, 1959, Ajax did not engage in any business activity other than to negotiate the purchase of the notes in question; and that during the same period Ajax had no assets other than the notes and a small amount of cash. The District Court further found (I-R. 112, 116, 125) that no stockholder influential in taxpayer, either by virtue of an executive office or because of substantial stock ownership, declined to participate in the formation of Ajax, and that the close relationship of stockholders between taxpayer and Ajax has not been disproven by taxpayer. We submit

that all of these findings by the District Court must be accepted for purposes of the instant review, since it is the duty and prerogative of the trial court to draw inferences and determine what the evidence means (*United States* v. *McNair Realty Co.*, 298 F. 2d 35 (C.A. 9th)), and the findings of the trial court should not be overturned unless clearly erroneous (*United States* v. *Gypsum Co.* 333 U.S. 364, 394-395; *United States* v. *First Security Bank*, 334 F. 2d 120 C.A. 9th)). It cannot seriously be contended that the findings of the District Court were clearly erroneous,[3] and we submit that they fully support the decision for the reasons given above and in the District Court's opinion.

It is true that in *Knetsch v. United States*, 364 U.S. 361, affirming 272 F. 2d 200 (C.A. 9th), the Supreme Court, in holding that certain transactions created no indebtedness which would authorize deductions for amounts paid as interest, did state in its opinion (p. 365) that it would put aside a finding by the trial court that Knetsch's only motive was an attempt to secure an interest deduction. However, the Court went on to hold that what was done in *Knetsch,*

[3] Indeed, we do not understand that taxpayer disputes the accuracy of the District Court's findings of fact (Br. 7, 27) except in two minor particulars (Br. 25) which will be discussed later on in this brief.

apart from the tax motive, was not what the statute permitting interest deductions intended, and that in substance and reality Knetsch's transactions were a sham, since they did not appreciably affect his beneficial interest and there was nothing of substance to be realized by Knetsch from the transactions beyond an attempted tax deduction.

We do not interpret the *Knetsch* decision to be at variance with cases such as *Lynch, supra,* where a tax avoidance motive was held to be relevant and material. In *Knetsch* the Court was dealing with a claimed deduction for amounts paid as interest and there was no problem as to whether escaping taxation constitutes a business transaction within the meaning of a statute the words of which describe or presuppose a business transaction. The basic question in *Knetsch* was whether there was a real indebtedness and the Court held there was not: looking through form to substance, the transaction was a sham.

In the instant case Ajax engaged in no business during the period involved except the purchase of taxpayer's notes at a discount, and this was concededly a tax avoidance activity instigated by taxpayer and its stockholders and done by Ajax at their bidding. If Ajax had independent income of its own, it would be entitled to be treated as a separate entity insofar as

its own taxes were concerned (*Paymer* v. *Commissioner*, 150 F. 2d 334 (C.A. 2d)); nevertheless, when we look through form to substance, it seems clear that Ajax was merely an instrument utilized by and in behalf of the taxpayer in order to buy back its notes at a discount. Tax avoidance was the only discernible reason for this subterfuge, and in the circumstances Ajax was nothing but a conduit, agent, alter ego, tool or instrumentality by which taxpayer drew in its notes at a discount. Cf. *Patterson* v. *Commissioner*, decided October 26, 1966 (25 T.C.M. 1230), affirmed *per curiam* May 7, 1968 (C.A. 2d) (68-2 U.S.T.C., par. 9471). It cannot lightly be presumed that Congress intended to allow the taxpayer here to escape taxation by use of a corporate straw man.

Moreover, even if the tax avoidance motive be disregarded in the instant case, the result should be the same. In this connection, attention is invited to *United States* v. *General Geophysical Co.*, 296 F. 2d 86, 88 (C.A. 5th), certiorari denied, 369 U.S. 849, where the court rejected the contention of the taxpayer-corporation that it was entitled to a stepped-up basis for certain property by virtue of a transfer of the property to its major stockholders and an almost immediate repurchase from them by the corporation at an enhanced valuation. In substance and reality, there

never had been a transfer and repurchase in that case. In the instant case, we have a situation where not only was there a dominant tax avoidance motive, but even if that motive were put to one side, still, the things that were done (formation of Ajax and purchase by it of taxpayer's notes at a discount) demonstrate irresistibly that taxpayer in substance purchased the notes through the medium or agency of Ajax. Certainly there is no more reason to treat Ajax as the real purchaser and taxpayer as a stranger in the instant case than there was to treat the taxpayer in *Geophysical* as a real purchaser of assets at a stepped-up basis. Such situations may be compared to the one in the *Knetsch* case, *supra*, where the Supreme Court looked through form to substance and refused to countenance a device for minimizing taxes that however perfect in form would nevertheless defeat the statutory purpose if accepted at face value. And even if Ajax be treated as an independent tax entity for tax purposes generally, still, insofar as concerns the particular transaction here involved, Ajax was nothing but a tool of taxpayer and its stockholders (as we have pointed out above), and it flouts logic and reason to conclude, as taxpayer would have us do, that Congress intended to exempt from the command of Section 61(a)(12) of the Code the income realized from discharge of indebtedness merely because the acquisition of the taxpayer's obli-

gations was effectuated by a straw man set up by the taxpayer.

II

SECTION 269(a) OF THE 1954 INTERNAL REVENUE CODE IS ALSO APPLICABLE

The District Court held (I-R. 118, 123, 127) that Section 269(a) of the 1954 Internal Revenue Code (Appendix A, *infra*) is also applicable in the instant case and constitutes an additional ground for the denial of the taxpayer's claims for refund. We submit that the holding is correct.

Section 269(a) provides that if any person or persons acquire, directly or indirectly, control of a corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of federal income tax by securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. The statute further provides that control means at least 50 percent of the voting power or value of all stock in the acquired corporation.

Section 269(a) is substantially the same as its predecessor, Section 129(a) of the Internal Revenue Code of 1939, which was added to that Code by Section 128 of the Revenue Act of 1943, c. 63, 58 Stat. 21. The

Congressional purpose is explained in H. Rep. No. 871, 78th Cong., 1st Sess., p. 49 (1944 Cum. Bull. 901, 938), which reads in part as follows:

> This section adds a new section 129 to Chapter 1 of the Code providing that in the case of acquisitions on or after October 8, 1940, of an interest in or control of corporations or property which the Commissioner finds to be principally motivated by or availed of for the avoidance of income or excess profits tax by securing the benefit of a deduction, credit, or other allowance, then the tax benefits are to be disallowed or allowed only in part in a manner consistent with the prevention of tax avoidance. This section is designed to put an end promptly to any market for, or dealings in, interests in corporations or property which have as their objective the reduction through artifice of the income or excess profits tax liability.
>
> The crux of the devices which have come to the attention of your committee has been some form of acquisition on or after the effective date of the Second Revenue Act of 1940, but the devices take many forms. Thus, the acquisition may be an acquisition of the shares of a corporation, or it may be an acquisition which follows by operation of law in the case of a corporation resulting from a statutory merger or consolidation. The person, or persons, making the acquisition likewise vary, as do the forms or methods of utilization under which tax avoidance is sought. Likewise, the tax benefits sought may be one or more of several deductions or credits, including the utilization of excess profits, credits, carry-overs and carry-backs of losses or unused excess profits credits, and anticipated expense of other deductions. In the light of these considerations, the section has not confined itself to a description of any particular methods for

carrying out such tax avoidance schemes but has included within its scope these devices in whatever form they may appear. For similar reasons, the scope of the terms used in the section is to be found in the objective of the section, namely, to prevent the tax liability from being reduced through the distortion or perversion affected through tax avoidance devices. The term "Federal income or excess profits tax" refers to any Federal tax imposed by Congress upon an income base. The term "deduction, credit or allowance" has reference to any provision which has the effect of diminishing the tax liability resulting from the gross amount of any item of income or the aggregate of the gross amounts of any or all items thereof.

Since the objective of the section is to prevent the distortion through tax avoidance of the deduction, credit, and allowance provisions, the section does not abrogate or delimit, but supplements and extends, the present provisions of the Code, and the principles established by judicial decisions, having the effect of preventing the avoidance of taxes. (See I. R. C., sections 45, 102, 112, 115, and 337; *Gregory* v. *Helvering*, 293 U.S. 465 [Ct. D. 911, C.B. XIV, 193 (1935)]; *Griffiths* v. *Commissioner*, 308 U.S. 355 [Ct. D. 1431, C. B. 1940-1, 136]; *Higgins* v. *Smith*, 308 U.S. 473 [Ct. D. 1434, C.B. 1940-1, 127]; *United States* v. *Joliet & Chicago R. Co.*, 315 U.S. 44 [Ct. D. 1540, C.B. 1942-1, 196]; *Moline Properties* v. *Commissioner*, 319 U.S. 436 [Ct. D. 1584, C. B. 1943, 1011]; *Interstate Transit Lines* v. *Commissioner*, 63 Sup. Ct., 1279 [Ct. D. 1586, C. B. 1943, 1016]; *J. D. & A. B. Spreckles Co.* v. *Commissioner*, 41 B.T.A. 370).

The report of the Senate Committee on Finance (S. Rep. No. 627, 78th Cong., 1st Sess., p. 58 (1944

Cum. Bull. 973, 1016)) contains the following language:

> The objective of the section, as stated in the report on the House bill, is to prevent the distortion through tax avoidance of the deduction, credit, or allowance provisions of the Code, particularly those of the type represented by the recently developed practice of corporations with large excess profits (or the interests controlling such corporations) acquiring corporations with current, past, or prospective losses or deductions, deficits, or current or unused excess profits credits, for the purpose of reducing income and excess profits taxes. The House report also recognizes that the legal effect of the section is, in large, to codify and emphasize the general principle set forth in *Higgins* v. *Smith* (308 U.S. 473 [Ct. D. 1434, C. B. 1940-1, 127]), and in other judicial decisions, as to the ineffectiveness of arrangements distorting or perverting deductions, credits, or allowances so that they no longer bear a reasonable business relationship to the interests or enterprises which produced them and for the benefit of which they were provided.

See also Treasury Regulations on Income Tax (1954 Code), Sections 1.269-1, 1.269-2 and 1.269-3, Appendix A., *infra.*

It is readily apparent that Section 269 of the Code, like its predecessor (Section 129 of the 1939 Code), is broad in scope and specifically prohibits the allowance of tax benefits from acquisitions made principally for tax avoidance purposes. Many cases have been de-

cided under these statutes, some of which are as follows: *American Pipe & Steel Corp.* v. *Commissioner*, 243 F. 2d 125 (C.A. 9th); *Commissioner* v. *British Motor Car Distributors, Ltd.*, 278 F. 2d 392 (C.A. 9th); *Bonneville Locks Towing Co.* v. *United States*, 343 F. 2d 790 (C.A. 9th); *J. T. Slocomb Co.* v. *Commissioner*, 334 F. 2d 269 (C.A. 2d); *Luke* v. *Commissioner*, 351 F. 2d 568 (C.A. 7th); *R. P. Collins & Co.* v. *United States*, 303 F. 2d 142 (C.A. 1st).

As noted by the District Court herein (I-R. 121), the requirement as to "principal purpose" means that the tax avoidance purpose must exceed in importance any other purpose. See *Hawaiian Trust Co.* v. *United States*, 291 F. 2d 761 (C.A. 9th). This is a question of fact (*Bonneville Locks Towing Co.* v. *United States*, *supra*; *J. T. Slocomb Co.* v. *Commissioner*, *supra*); and as pointed out in the previous section of this brief, the District Court specifically found that the stockholders of taxpayer who created Ajax had the primary purpose of tax avoidance which far exceeded in significance any other motivation. (I-R. 118, 122.) Moreover, this tax avoidance motive has been conceded by taxpayer and is not denied. (Br. 26, 28.)

However, in order to justify the application of Section 269 in the instant case, it must also appear that the control of Ajax was acquired by a person or

persons in order to secure the benefit of a deduction, credit, or other allowance which such person or persons would not otherwise enjoy. In this connection the District Court found (I-R. 112) that no stockholder influential in taxpayer either by virtue of an executive office or because of substantial stock ownership, declined to participate in the formation of Ajax and that the large majority of stockholders of taxpayer (85.44%) committed themselves to the purchase of Ajax stock. While taxpayer apparently disputes this 85.44 figure (Br. 25), and attention will be given to that aspect of the case in the next section of this brief, nevertheless, we understand it to be undisputed that the effective and controlling stockholders in both corporations (taxpayer and Ajax) were identical; and we further understand it to be undisputed that such stockholders held over 50 percent of the stock of both companies (I-R. 120; Br. 4, 7, 10). It accordingly appears that stockholders of taxpayer owning over 50 percent of its stock acquired more than 50 percent of the stock of Ajax; and this would constitute direct control of Ajax by such stockholders and indirect control of Ajax by the taxpayer.[4] Cf. *Southland Corp.* v. *Campbell*, 358 F. 2d 333 (C.A. 5th).

It seems clear that the acquisition of Ajax was

[4] It further appears that all of the directors of Ajax were also directors of taxpayer. See Exs. W, BB.

designed to secure the benefit of a deduction, credit or other allowance which the taxpayer and its stockholders would not otherwise enjoy, since, as succinctly pointed out by the District Court (I-R. 120-121), the hoped-for tax benefits were the net operating loss deductions which would not be available as carryovers from 1957 if absorbed by income for that year. As stated by the District Court (I-R. 121):

> Obviously, New Harris [taxpayer] itself must suffer losses without regard to Ajax before the carryover provisions apply. The amount of the carryover available to New Harris in a given year will be directly affected by the amount of income attributed to New Harris in earlier years, including the taxable year ended March 31, 1957 with which this case is concerned. The tax attributes of the formation and activity of Ajax directly affect these calculations of New Harris income for the period in question, and in turn determine the amount of carryover which New Harris is entitled to claim.

Thus the benefit of the carryovers (if allowable) would accrue directly to the taxpayer and indirectly to its stockholders, the majority of which concededly participated in the plan. There is no question but that the purchase by taxpayer of its obligations at a discount would result in income to taxpayer sufficient to absorb the claimed operating loss carryovers (*United States* v. *Kirby Lumber Co.*, *supra*); and taxpayer does not contend otherwise.

The situation in the instant case is quite similar to the one in *Commissioner* v. *British Motor Car Distributors, Ltd., supra,* where this Court said (278 F. 2d, p. 395):

> The corporation contends, as stated by the Tax Court, that the benefit to the stockholders (as distinguished from that to the corporate taxpayer) is too tenuous to bring the section into play. Tenuous or not, it is the benefit which actuated these persons in acquiring this corporation and is thus the very benefit with which this section is concerned. It is not for the courts to judge whether the benefit to the acquiring persons is sufficiently direct or substantial to be worth acquiring. That judgment was made by the acquirers. The judicial problem is whether the securing of the benefit was the principal purpose of the acquisition. If it was, the allowance of the deduction is forbidden.***

See also *Bush Hog Manufacturing Co.* v. *Commissioner,* 42 T.C. 713, 729, Acquiescence, 1964-2 Cum. Bull. 4; Treasury Regulations on Income Tax (1954 Code), Section 1.269-3.

In the circumstances, we submit that the District Court made no error in holding as it did that Section 269(a) of the Code, as well as Section 61(a)(12), requires the denial of the tax refund sought by the taxpayer in this action.

III

THE TAXPAYER'S CRITICISMS OF THE DISTRICT COURT'S DECISION ARE NOT WELL GROUNDED.

A. *As to the Section 61(a)(12) issue*

The taxpayer says (Br. 30) that the District Court did not explain how its determination as to tax avoidance would result in the attribution to taxpayer of the purchase of the notes. However, the explanation may be found in the District Court's opinion which reads in part as follows (I-R. 117):

> Under all the facts and circumstances shown by the evidence, the court finds and holds that tax avoidance was the primary, dominant and moving purpose for the formation of Ajax and for its single business activity in purchasing the New Harris indebtedness. Without the purpose of tax avoidance, formation of Ajax would not have occurred. Ajax was formed essentially for the purpose of doing for New Harris that which New Harris itself, due to income tax considerations, decided not to do, namely, acquire the New Harris mortgage notes at a discount.

See also I-R. 127, where the District Court concluded as a matter of law that:

> 1. The New Harris notes were in substance purchased by New Harris and should be so treated for purposes of determining the federal income tax liability. Accordingly, New Harris realized taxable income under Section 61(a)(12) of the

> Internal Revenue Code of 1954 upon the purchase of the New Harris notes at a discount.

Thus, the District Court has in effect found and concluded that Ajax acted merely as a conduit for the purchase of the two notes by the taxpayer (New Harris), and therefore such purchase should be treated for tax purposes as having been made by the taxpayer. This is in accordance with cases such as *Gregory* v. *Helvering*, *supra*, and *Minnesota Tea Co.* v. *Helvering*, *supra*. In the *Minnesota Tea* case the Court said (302 U.S., pp. 613-614):

> A given result at the end of a straight path is not made a different result because reached by following a devious path. The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come to their hands, so transparently artificial that further discussion would be a needless waste of time. The relation of the stockholders to the matter was that of a mere conduit.***

See also *Commissioner* v. *Court Holding Co.*, *supra*, where the Court said (324 U.S., p. 334) that a sale by one person cannot be transformed into a sale by another by using the latter as a conduit through which to pass title. This principle was recently applied by the Fifth Circuit in an analogous case (*Davant* v. *Commissioner*, 366 F. 2d 874, certiorari denied, 386 U.S. 1022), where the court looked through form to sub-

stance in treating an alleged sale to one Bruce as a mere paper subterfuge and holding that he was a mere conduit by means of which the taxpayers hoped to disguise the true nature of the transaction for tax purposes. In this connection the Fifth Circuit said (366 F. 2d, p. 881):

> ***to allow the "sale" to Bruce, Jr. to divert our attention from the tax policies enacted by Congress would be to exalt form above all other criteria. He served no function other than to divert our attention and avoid tax. Stated another way, his presence served no legitimate nontax-avoidance business purpose. Cf. *Commissioner of Internal Revenue* v. *Court Holding Co.*, 324 U.S. 331, 65 S.Ct. 707 (1945); *Campbell* v. *Wheeler*, 342 F. 2d 837 (5 Cir. 1965); *United States* v. *Lynch*, 192 F. 2d 718 (9 Cir. 1951), cert. den., 343 U.S. 934, 72 S.Ct. 770, 96 L.Ed. 1342 (1952);***

And see *Factor* v. *Commissioner*, 281 F. 2d 100, 110-113 (C.A. 9th), certiorari denied, 364 U.S. 933; *Babcock* v. *Phillips*, 372 F. 2d 240 (C.A. 10th), certiorari denied, 387 U.S. 918.

The taxpayer relies heavily (Br. 31-34) on *Chisholm* v. *Commissioner*, 79 F. 2d 14 (C.A. 2d), but we do not read that case as being contrary to the decision of the District Court in the instant one. *Chisholm* merely held that the taxpayers formed a real, enduring partnership which acted for itself and not as a conduit or agent for the taxpayers individually in

making the sale of the transferred stock. Thus, the transaction in *Chisholm* was considered as having economic substance, and the tax avoidance motive for formation of the partnership did not operate to change the result. In the instant case the major portion of the funds used to purchase the two mortgage notes was provided by taxpayer and the remainder of the purchase price was furnished by its principal stockholders. (I-R. 126.) Everybody concerned apparently thought that the two notes were extinguished upon their purchase by Ajax, and in 1959 the notes were in fact turned over to taxpayer by Ajax as a contribution to capital. (I-R. 100-101; Exs. LL, MM.) The conceded reason for this round-about process was tax avoidance, and looking through form to substance it is plain that the District Court had warrant to treat Ajax as a mere conduit or tool of the taxpayer. We take it that nobody contends that Ajax had any choice in the matter or that it would or could have refused to purchase the notes. Thus, Ajax was a mere puppet of taxpayer in making the purchase. Cf. *National Lead Co.* v. *Commissioner*, 336 F. 2d 134, 140-141 (C.A. 2d), certiorari denied, 380 U.S. 908.

Cases such as Sun Properties v. United States, 220 F. 2d 171 (C.A. 5th), cited by taxpayer (Br. 35-38), do not advance its cause here, and, indeed, it will

be noted that the court in *Sun Properties* stated that transactions are subject to careful scrutiny when the only ascertainable motive is tax avoidance. In the instant case the District Court carefully scrutinized the transactions and concluded that they were in substance a purchase by taxpayer. See also *Goldstein* v. *Commissioner*, 298 F. 2d 562, 568 (C.A. 9th); and cf. *United States* v. *Ramos*, 393 F. 2d 618 (C.A. 9th).

In *Twin Oaks Co.* v. *Commissioner*, 183 F. 2d 385 (C.A. 9th), cited by taxpayer (Br. 38-39), the court held that the change in business structure from corporation to partnership had sufficient reality and substance to preclude taxing all of the income of the business to the corporation. We do not read that decision as having any material bearing on the instant case. Here the taxpayer and its stockholders had complete domination and control over Ajax and Ajax would concededly have been dissolved if it had been unable to purchase the notes for taxpayer. (II-R. 99.)[5]

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[5] Thus Mr. Bez testified (II-R. 99):

> Q. Mr. Bez, if you are not able to acquire those two mortgage notes due to some unforeseen difficulty, would the stock of Ajax have been issued anyway on February 21, 1957, if you hadn't been able to acquire the two mortgage notes?
>
> A. If we wasn't able, no.
>
> Q. Can you tell me why the Ajax stock would not have been issued in that eventuality?

Footnote continued on page 35

The taxpayer says (Br. 40-42) that purchase of mortgage notes at a discount from unrelated third parties is a legitimate business activity which does not lose its quality as such merely because motivated by tax avoidance. However, that assertion is too broad and in effect begs the question which is whether the taxpayer in substance purchased the notes through Ajax. The actual purchase was indeed a business transaction, but the only reason Ajax was brought into the picture at all was to divert attention and avoid tax. See *Davant* v. *Commissioner*, *supra*. Thus, the business end of the transaction must be attributed to taxpayer as the District Court held.

Cases such as *Koppers Co.* v. *Commissioner*, 2 T.C. 152, Acquiescence, 1943 Cum. Bull. 14, relied upon by taxpayer (Br. 43-48), do not support its views. The facts are not comparable to the facts of the instant case. In *Koppers*, the parent company purchased bonds theretofore issued by its subsidiary which the latter had neither the funds nor the credit to buy.

A. Well, we had the money, and if he wasn't able to buy those notes, we would have returned the money to the original fellows that put up the $142,000.00 and dissolved the company, and that would be it.

THE COURT: Dissolve Ajax?

THE WITNESS: Dissolve Ajax, that is the only thing we could do if we weren't able to buy those notes.

Here, the taxpayer had the means to purchase its obligations and actually financed the transaction. Ajax was the mere puppet of taxpayer, as we have pointed out above. See also I-R. 116, where the District Court commented on *Koppers*.

The taxpayer says (Br. 48-54) that all taxpayers have a clear right to employ any legitimate method of conducting their affairs to avoid incurring a tax liability which might have resulted had a different method been adopted. Nobody disputes that as a general proposition, and the District Court recognized its validity. (I-R. 115.) But it does not follow that it is applicable here. It seems clear that an arrangement which served no legitimate nontax-avoidance business purpose does not have to be accepted at face value, for tax purposes, and that substance must control over form in a case of this character. *Davant* v. *Commissioner*, *supra*. We submit that the District Court did not err in so holding in the instant case. Cases such as *Kobacker* v. *Commissioner*, 37 T.C. 882, Acquiescence, 1964-2 Cum. Bull. 6; and *Chase* v. *Commissioner*, decided July 23, 1965 (24 T.C.M. 1054), cited by taxpayer (Br. 48-54), turn on their peculiar facts, and we do not read those decisions as having any material bearing on the instant case. Here, Ajax was formed to buy the taxpayer's notes and actually did so with funds and credit supplied in major part by the

taxpayer. Ajax had no choice and had to do what it was formed and established for the sole purpose of doing, as we have pointed out above. In the circumstances, Ajax was nothing but a conduit, agent, alter ego, tool or instrumentality by which taxpayer drew in the notes at a discount, as we have also noted above. It makes no difference what we call Ajax in this connection, for the "label counts for little." *Stearns Co.* v. *United States*, 291 U.S. 54, 61. For the purposes of the instant transaction, Ajax was completely controlled by taxpayer and its stockholders and Ajax had no independence at all.

The taxpayer contends (Br. 54-55) that if the corporate entity of Ajax were to be disregarded, its corporate activities would be attributable only to its stockholders, not to the taxpayer. But the activity that concerns us here, purchase of taxpayer's obligations at a discount, was designed and intended by all concerned to be for the primary tax benefit of the taxpayer, and taxpayer's stockholders had that end in view when Ajax was organized. *Commissioner* v. *Montgomery*, 144 F. 2d 313 (C.A. 5th), referred to by the taxpayer (Br. 54-55), is not in point, and it does not support the taxpayer's position here.

B. *As to the Section 269(a) issue*

The taxpayer, citing the decision of this Court in

Commissioner v. *British Car Distributors, Ltd., supra,* but ignoring its true rationale, states (Br. 56-57) that although the stockholders controlling the taxpayer did acquire control of Ajax (for tax avoidance purposes), still, the only deduction involved is the operating loss claimed by taxpayer, and Section 269(a) is inapplicable because taxpayer did not acquire control of Ajax, nor did Ajax acquire control of taxpayer. We submit that the argument is without merit. In the first place, taxpayer did acquire indirect control of Ajax since taxpayer's controlling stockholders concededly also controlled Ajax, and the directors of Ajax were also directors of taxpayer, as pointed out in the previous section of this brief. The use of the words "directly or indirectly" in the statute should be read in the light of its manifest purpose to put an end to all devices in whatever form they may appear, whereby control of a corporation is acquired for the purpose of obtaining tax benefits (including carryovers and carrybacks of losses) which would not otherwise be enjoyed. See H. Rep. No. 871, *supra.* It would be incompatible with such sweeping objectives to hold, as taxpayer would have us do, that taxpayer did not acquire indirect control of Ajax in the circumstances of the instant case.[6]

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[6] *Brick Milling Co.* v. *Commissioner,* decided November 13, 1963 (22 T.C.M. 1603); and *Thomas E. Snyder Sons Co.* v. *Commissioner,* 288 F. 2d 36 (C.A. 7th), certiorari denied, 368 U.S. 823, referred to by the taxpayer (Br. 58-59), are distinguishable on the facts.

Moreover, even if taxpayer were right in this respect (which we deny), it would not change the result since its controlling stockholders indisputably acquired direct control of Ajax within the purview of the statute, and they were persons having sufficient interest in the claimed deductions to bring the statute into operation. The taxpayer admits (Br. 57) that the stockholders controlling taxpayer did acquire control of Ajax in the course of the transactions here involved, but takes the position that no deduction, credit, or other allowance claimed by Ajax or such stockholders is challenged. However, the taxpayer is wrong, for the acquirers were plainly actuated by the benefits to taxpayer which they hoped to achieve, and although the acquiring stockholders were not claiming the deductions in their individual returns, nevertheless, they, as stockholders, certainly had a beneficial interest in the deductions of the taxpayer. See *Commissioner* v. *British Motor Car Distributors, Ltd., supra.*

The taxpayer relies heavily (Br. 59-61) on *Maxwell Hardware Co.* v. *Commissioner*, 343 F. 2d 713 (C.A. 9th), but that case was not ignored by the District Court (I-R. 119) and it is not at variance with our position here. In that case the acquirers did not have the required 50 percent control; in the instant case there is no question but that they did.

The taxpayer presents a strained argument (Br. 61-66) designed to show that it did not secure any tax benefit from the purchase of the notes by Ajax. But that argument is essentially fallacious, for, as pointed out above and in the opinion of the District Court herein, the very purpose of the transaction was to enable the taxpayer to avoid the amount of 1957 income entailed in the purchase of its notes at a discount; and of course such avoidance, if successful, would preclude the absorption of the carryovers to 1960 and 1961 which are claimed by the taxpayer as operating loss deductions. Thus taxpayer (and its stockholders) are seeking a tax benefit through the acquisition of Ajax which would not otherwise be enjoyed.

Taxpayer's reliance (Br. 63-66) on *Nutt* v. *Commissioner*, 39, T.C. 231, affirmed on another point, 351 F. 2d 452 (C.A. 9th), certiorari denied, 384 U.S. 918; and *Cromwell Corp.* v. *Commissioner*, 43 T.C. 313, Acquiescence, 1965-2 Cum. Bull. 4, is misplaced. In the *Nutt* case, the Internal Revenue Service determined that two newly-organized corporations were shams so that their net income should be taxed to the individuals who organized them. The Tax Court in overruling the Service held that the corporations were real business entities, taxable as such, and that Section 269 was inapplicable since the Service had not disallowed to the individual taxpayers any deductions

laimed by them, but, rather, increased both the in-
ome and deductions claimed by them on their returns.
n the instant case, the tax authorities and the Dis-
rict Court have disallowed the carry-forwards claimed
y taxpayer and those are the deductions which would
e enjoyed only if the transparent tax avoidance plan
ere involved were upheld. The *Cromwell* case is also
listinguishable on the facts and it is of no assistance
o the taxpayer here.

In the light of the foregoing considerations, we
ubmit that the decision of the District Court is in all
espects correct.[7]

We are not unmindful of taxpayer's specifications of errors numbers and 5 (Br. 25). Taxpayer says in specification 4 that the trial court rred in finding that 85.44 percent of taxpayer's stockholders com-itted themselves to purchase Ajax stock and notes; and in specifica-on 5 that the trial court erred in finding that taxpayer paid Ajax 66,737 on May 17, 1957, since such payment was in fact made on pril 2, 1957.

As to the 85.44 figure, this is based on a tabulation attached to his brief as Appendix B which shows that on February 21, 1957 (date f purchase of taxpayer's notes by Ajax), Ajax shareholders held 5.44 percent of taxpayer's stock (12,816 shares out of 15,000 shares utstanding). This computation was presented to and accepted by he District Court. It was based upon a determination by the Gov-rnment that the majority of the stockholders of taxpayer (New Har-is) and Ajax fell into one of three groups of investors; that such roups would follow their leader and that the registration of the tock was not always indicative of the real beneficial ownership. See Nutt v. *Commissioner, supra,* 351 F. 2d, p. 454; *Commissioner* v. *Scatena,* 85 F. 2d 729, 732 (C.A. 9th); *Bonsall* v. *Commissioner,* 317 F. 2d 61, 63 (C.A. 2d). However, it does not appear that the exact

Footnote continued on page 42

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted,

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SEPTEMBER, 1968.

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figure is important in the instant case, since it is undisputed that the larger number of the stockholders of taxpayer subscribed for Ajax stock and notes (Br. 4, 7, 26, 27) and that no stockholder influential in taxpayer, either by virtue of an executive office or because of substantial stock ownership, declined to participate in the formation of Ajax (Br. 10). Moreover, the point does not seem to be an appropriate one for consideration by this Court; and if the taxpayer desires to contest the District Court's findings, taxpayer should at least show why the finding is wrong and also what is the correct figure, since the taxpayer has the burden of proof. *Helvering* v. *Taylor,* 293 U.S. 507, 514.

As to the taxpayer's specification of error number 5, it does appear that the date should be April 2, 1957, as asserted by taxpayer (Br. 25), rather than May 17, 1957, as found by the District Court (I-R. 126); but in any event the error appears to be immaterial and taxpayer does not contend that it is material.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel, by mailing four copies hereof on this ..... day of ....., 1968, in an envelope, with postage prepaid, properly addressed to them as follows:

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APPENDIX A

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.* — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * * * *

(12) Income from discharge of indebtedness;

* * * * *

(26 U.S.C. 1964 ed., Sec. 61.)

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) *In General.* — If —

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisi-

tion mas made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

* * * * *

(26 U.S.C. 1964 ed., Sec. 269.)

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.61-12 *Income for discharge of indebtedness*

(a) *In general.* The discharge of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, the debtor realizes income in the amount of the debt as compensation for his services. A taxpayer may realize income by the payment or purchase of his obligations at less than their face value.***

* * * * *

(c) *Sale and purchase by corporation of its bonds.* (1) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. If the corporation purchases any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. If, how-

ever, the corporation purchases any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is income for the taxable year.

* * * * *

(5) For purposes of this paragraph, a debenture, note, or certificate or other evidence of indebtedness, issued by a corporation and bearing interest shall be given the same treatment as a bond.

* * * * *

(26 C.F.R., Sec. 1,61-12.)

Sec. 1.269-1 [as added by T.D. 6595, 1962-1 Cum. Bull. 43] *Meaning and use of terms.****

(a) *Allowance.* The term "allowance" refers to anything in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among things, a deduction, a credit, an adjustment, an exemption, or an exclusion.

(b) *Evasion or avoidance.* The phrase "evasion or avoidance" is not limited to cases involving criminal penalties, or civil penalties for fraud.

(c) *Control.* The term "control" means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock of the corporation. For control to be "acquired on or after October 8, 1940", it is not necessary that all of such stock be acquired on or after October 8, 1940. Thus, if A, on October 7, 1940, and at all times thereafter, owns 40 percent of the stock of

X Corporation and acquires on October 8, 1940, an additional 10 percent of such stock, an acquisition within the meaning of such phrase is made by A on October 8, 1940. Similarly, if B, on October 7, 1940, owns certain assets and transfers on October 8, 1940, such assets to a newly organized Y Corporation in exchange for all the stock of Y Corporation, an acquisition within the meaning of such phrase is made by B on October 8, 1940. If, under the facts stated in the preceding sentence, B is a corporation, all of whose stock is owned by Z Corporation, then an acquisition within the meaning of such phrase is also made by Z Corporation on October 8, 1940, as well as by the shareholders of Z Corporation taken as a group on such date, and by any of such shareholders if such shareholders as a group own 50 percent of the stock of Z on such date.

(d) *Person.* The term "person" includes an individual, a trust, an estate, a partnership, an association, a company, or a corporation.

(26 C.F.R., Sec. 1.269-1.)

Sec. 1.269-2 [as added by T.D. 6595, *supra*] *Purpose and scope of section 269.*

(a) *General.* Section 269 is designed to prevent in the instances specified therein the use of the sections of the Internal Revenue Code providing deductions, credits, or allowances in evading or avoiding Federal income tax. See § 1.269-3.

(b) *Disallowance of deduction, credit, or other allowance.* Under the Code, an amount otherwise constituting a deduction, credit, or other allowance becomes unavailable as such under certain circumstances. Characteristic of such circumstances are those in which the effect

of the deduction, credit, or other allowance would be to distort the liability of the particular taxpayer when the essential nature of the transaction or situation is examined in the light of the basic purpose or plan which the deduction, credit, or other allowance was designed by the Congress to effectuate. The distortion may be evidenced, for example, by the fact that the transaction was not undertaken for reasons germane to the conduct of the business of the taxpayer, by the unreal nature of the transaction such as its sham character or by the unreal or unreasonable relation which the deduction, credit, or other allowance bears to the transaction. The principle of law making an amount unavailable as a deduction, credit, or other allowance in cases in which the effect of making an amount so available would be to distort the liability of the taxpayer, has been judicially recognized and applied in several cases. Included in these cases are *Gregory* v. *Helvering* (1935) (293 U.S. 465; Ct. D. 911, C.B. XIV-1, 193); *Griffiths* v. *Helvering* (1939) (308 U.S. 355; Ct. D. 1431, C.B. 1940-1, 136); *Higgins* v. *Smith* (1940) (308 U.S. 473; Ct. D. 1434, C.B. 1940-1, 127) and *J. D. & A. B. Spreckles Co.* v. Commissioner (1940) (41 B.T.A. 379). In order to give effect to such principle, but not in limitation thereof, several provisions of the Code, for example, section 267 and section 270, specify with some particularity instances in which disallowance of the deduction, credit, or other allowance is required. Section 269 is also included in such provisions of the Code. The principle of law and the particular sections of the Code are not mutually exclusive and in appropriate circumstances they may operate together or they may operate separately. See, for example, § 1.269-6.
(26 C.F.R., Sec. 1.269-2.)

Sec. 1.269-3 [as added by T.D. 6595, *supra*]

Instances in which section 269(a) disallows a deduction, credit, or other allowance. (a) Instances of disallowance. Section 269 specifies two instances in which a deduction, credit, or other allowance is to be disallowed. These instances, described in paragraphs (1) and (2) of section 269(a), are those in which—

(1) Any person or persons acquire, or acquired on or after October 8, 1940, directly, or indirectly, control of a corporation, or

(2) Any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation (not controlled, directly or indirectly, immediately before such acquisition by such acquiring corporation or its stockholders), the basis of which property in the hands of the acquiring corporation is determined by reference to the basis in the hands of the transferor corporation.

In either instance the principal purpose for which the acquisition was made must have been the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such other person, or persons, or corporation, would not otherwise enjoy. If this requirement is satisfied, it is immaterial by what method or by what conjunction of events the benefit was sought. Thus, an acquiring person or corporation can secure the benefit of a deduction, credit, or other allowance within the meaning of section 269 even though it is the acquired corporation that is entitled to such deduction, credit, or other allowance in the determination of its tax. If the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose. This does not mean that only those acquisitions

fall within the provisions of section 269 whic would not have been made if the evasion or avoic ance purpose was not present. The determinatio of the purpose for which an acquisition was mad requires a scrutiny of the entire circumstance in which the transaction or course of conduct oc curred, in connection with the tax result claime to arise therefrom. For the presumption of a prir cipal purpose of tax evasion or avoidance, se section 269(c) and § 1.269-5.

(b) *Acquisition of control; transactions in dicative of purpose to evade or avoid tax.* If th requisite acquisition of control within th meaning of paragraph (1) of section 269(a) ex ists, the transactions set forth in the followin subparagraphs are among those which, in th absence of additional evidence to the contrary ordinarily are indicative that the principal pur pose for acquiring control was evasion or avoic ance of Federal income tax:

(1) A corporation or other business ente prise (or the interest controlling such corporatio or enterprise) with large profits acquires contr of a corporation with current, past, or prospectiv credits, deductions, net operating losses, or othe allowances and the acquisition is followed by suc transfers or other action as is necessary to brin the deduction, credit, or other allowance into cor junction with the income (see further § 1.269-6) This subparagraph may be illustrated by the fo lowing example:

Example. Individual A acquires all of th stock of L Corporation which has been engage in the business of operating retail drug store At the time of the acquisition, L Corporation ha net operating loss carryovers aggregating $100 000 and its net worth is $100,000. After the a

quisition, L Corporation continues to engage in the business of operating retail drug stores but the profits attributable to such business after the acquisition are not sufficient to absorb any substantial portion of the net operating loss carryovers. Shortly after the acquisition, individual A causes to be transferred to L Corporation the assets of a hardware business previously controlled by A which business produces profits sufficient to absorb a substantial portion of L Corporation's net operating loss carryovers. The transfer of the profitable business, which has the effect of using net operating loss carryovers to offset gains of a business unrelated to that which produced the losses, indicates that the principal purpose for which the acquisition of control was made is evasion or avoidance of Federal income tax.

(2) A person or persons organize two or more corporations instead of a single corporation in order to secure the benefit of multiple surtax exemptions (see section 11(c)) or multiple minimum accumulated earnings credits (see section 535(c) (2) and (3)).

(3) A person or persons with high earning assets transfer them to a newly organized controlled corporation retaining assets producing net operating losses which are utilized in an attempt to secure refunds.

* * * * *

(26 C.F.R., Sec. 1.269-3.)

APPENDIX B

AJAX SHAREHOLDERS HELD 85.44% OF NEW HARRIS STOCK ON FEBRUARY 21, 1957

	Shares of New Harris	Shares Ajax
Nick Bez	1,061.60	1,150
Peninsula Packers	2,735*	2,735
Trans-Pacific Fishing & Packing	352	352
Bergues Group		
Geneva Corporation	1,765	1,765
Ivan L. Best	441	441
Edward Heller	442	442
Wilbur-Ellis Group		
Brayton Wilbur	797	177
William A. Hinckley		44
H. A. Magnuson		89
R. B. Mattson		89
Ned Lewis		177

aats Group		
Hamilton Beasley	2,856	618
Donald Royce	161	
Staats & Co.		1,393
Fred Tuerk and relatives		1,957
J. E. Jardine (deceased)	608	
J. E. Jardine, Jr.	44	
W. L. Berger	18	
Mrs. R. M. Sturdevant	36	
Robert S. Burns	441	441
Finn Lepsoe	352	352
Thomas J. Bannon (Webster-Brinckley Co.)	706.40	706
Total	12,816	12,928
ercent of Total Shares Outstanding	85.44%	100%

1,764 shares were held jointly by Trans-Pacific Fish-
ıg & Packing and the Calvert Corporation who were
ıe predecessors of Peninsula Packers.

No. 22352

IN THE

United States Court of Appeals
For the Ninth Circuit

PETER PAN SEAFOODS, INC., a Washington corporation,
Appellant,

v.

THE UNITED STATES OF AMERICA,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE GEORGE H. BOLDT,
United States District Judge

REPLY BRIEF OF APPELLANT TAXPAYER

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REPLY BRIEF OF APPELLANT TAXPAYER

ARGUMENT IN REPLY

The Trial Court Did Not Hold That Ajax Was a Conduit, Agent, Alter Ego, Tool, Instrumentality, Straw Man or Puppet of Appellant Taxpayer and Any Such Assertion Is Incompatible with the Admitted Facts.

The entire argument made by the Government on the question raised under Section 61[1] in this case is based on the assertion that Ajax was nothing but a conduit, agent, alter ego, tool, instrumentality, straw man or pup-

1. Section 61(a)(12) of the Internal Revenue Code of 1954.

pet of Appellant taxpayer. This assertion is made, repeated and reasserted until it assumes the character of an incantation as the brief progresses.[2] The principal decisions of the Supreme Court of the United States and other Courts of Appeal, which establish that in matters relating to the Federal revenue form must give way to substance, are cited in the most orthodox fashion (Gov't Br. 14-21, 31-32). These are all admittedly sound decisions and some of them represent landmarks in the development of the law relating to Federal taxation.

The difficulty is that neither the Government's assertion nor the principles enunciated by this respectable array of authorities is directed at the issue presented by this appeal. The Trial Court did not hold, or even suggest, that Ajax was not a real corporation, organized by real stockholders, for a real purpose. Nor did the Trial Court hold or suggest that Ajax did not in fact buy the mortgage notes in question, borrow substantial sums from a bank and from its stockholders to pay for them, pledge them to the bank as security for its indebtedness, collect interest and principal on the indebtedness evidenced by the notes, and eventually become the sole stockholder of Appellant taxpayer, the position which it holds to this day. Indeed, any such holding on the part of the Trial Court would have been preposterous in face of the detailed factual account of the organization and history of Ajax and its relationship to Appellant taxpayer over the period from its organization in May, 1956, until the trial of this action in January of 1967, all of which has been stipulated and agreed to as outlined in the Statement of Facts in Appellant taxpayer's Opening Brief (Br. 7-23).

2. Government Brief, pp. 9, 20, 21-22, 31, 33, 37.

None of these facts are challenged by the Government as indeed they could not be, since the Government had agreed in the Pre-Trial Order that they are true (R. 84-103). It has never been suggested that the 49 paragraphs detailing the whole history of these transactions which make up the admitted facts in this proceeding, and the 40-odd related exhibits (Exs. A-I-UU), constitute or involve a vast web of fiction or unreality. These admitted facts state in concise, clear language what was done and what happened in connection with the organization of Ajax, its acquisition of the mortgage notes and its subsequent dealings with them, and how, through a series of unforeseen developments Mr. Bez and the Calverts came to acquire all of the stock of Ajax, and Ajax became the sole stockholder and owner of Appellant taxpayer. This chronology of admitted facts does not permit the conclusion or even an implication that Ajax is, or ever was, a straw man, puppet, instrumentality, tool, alter ego, or agent of Appellant taxpayer, which it now owns lock, stock and barrel (R. 99). That Ajax was a mere conduit for the acquisition of the mortgage notes and their eventual transmission to Appellant taxpayer is not even suggested by the Trial Court. Here again the detailed chronology of the admitted facts is entirely incompatible with any such contention.

On the contrary, the decision of the Trial Court on the Section 61 issue was based and rests solely on the legal conclusion which the Court derived from its finding that tax avoidance was the primary, dominant, moving purpose for the formation of Ajax and for its single business activity in purchasing the mortgage notes (R. 117, 127). What the Court did hold was that since tax avoid-

ance was the primary, dominant, moving purpose, the various transactions should be given an effect for Federal tax purposes different than what the effect would be in the absence of the tax avoidance purpose. In other words, because of the fact that Appellant taxpayer had good reason to purchase the notes but did not do so because of the tax consequences and the fact that stockholders of Appellant taxpayer decided that under these circumstances they should purchase the mortgage notes instead (since no unacceptable tax consequence would thereby result), the Trial Court concluded that the organization of Ajax by the stockholders to purchase the notes must be regarded as, in substance, a purchase by Appellant taxpayer, solely because of the tax avoidance purpose and intent which admittedly permeated the whole transaction.

It is the position of Appellant taxpayer that this was clearly error on the part of the Trial Court. As stated in Appellant taxpayer's Opening Brief, it is Appellant taxpayer's position that the motive of tax avoidance will not establish liability if the transaction does not do so without it (Br. 31-40). This principle is so firmly established by decisions of the Supreme Court, headed by *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935), and by decisions of the various Circuit Courts, including this Court, that it is no longer subject to serious contention. Furthermore, it has been firmly established that in order to test the true tax consequences of a transaction, the tax avoidance intent or motive should be set aside so that the transaction may be measured as though the tax avoidance element did not exist. *Knetsch v. United States*, 364 U.S. 361, 365, 5 L.Ed.2d 128, 131, 81 S.Ct. 132 (1960), *affirming Knetsch v. United States*, 272 F.2d 200 (9 Cir., 1959).

United States v. Lynch

The Government appears to suggest that the decision by this Court in *United States v. Lynch,* (9 Cir., 1951) 192 F.2d 718, is contrary to the principle stated above. We do not believe this to be the case, and a somewhat detailed examination of that case will demonstrate the fallacy of the Government's position.

In *Lynch,* Washington Fruit and Produce Co., which was in the business of growing, handling, warehousing and marketing fresh fruits and vegetables, declared a dividend in kind consisting of 21,977 boxes of apples to its three stockholders. At the meeting at which the dividend was declared, the three stockholders entered into an agreement with the corporation whereby the corporation was to dispose of the apples and account to the stockholders for the net proceeds from the sale. The apples were in the corporation's warehouse at the time, and were immediately sold by the corporation in the normal course of its business in the same manner as if no dividend had been declared. The corporation continued to engage in its normal business for about two months thereafter and was then liquidated.

This Court held that since it was intended all along that the corporation would proceed to sell the apples in the usual course of its business as a going concern, and that the corporation did in fact do so, the purported dividend must be ignored for tax purposes. Consequently, the gain on the sale of the apples was corporate income. The declaration of the dividend in apples, coupled with the three stockholders' agreement that the corporation proceed to sell them in the usual manner and distribute

the cash proceeds to the shareholders, was obviously not intended to result in a real distribution of the apples or a real sale of them by the stockholders. All that was intended, and all that really happened, was that the stockholders receive a cash dividend in the amount of the net proceeds from the sale of the apples. As far as the sale of the apples was concerned, nothing was done nor intended to be done, differently than if no dividend had been declared. Thus, the purported dividend accomplished nothing and was not intended to accomplish anything, other than the avoidance of the tax on the sale of the apples by the corporation. In other words, insofar as the apples were concerned, the dividend did not represent a real transaction at all, and this Court very properly held that since the corporation sold the apples, it was responsible for the resulting tax on the sale.

The true import of the Court's decision in *Lynch* is perhaps best illustrated by this Court's later decision in *Gensinger v. Comm'r*, (9 Cir., 1953) 208 F.2d 576. In that case, the sole stockholder of a corporation which was engaged in the business of producing cherries, apricots and peaches on its farm near Wenatchee, Washington, had for some time intended to liquidate the corporation. In the summer of 1943, while the fruit was being harvested, proceedings for the liquidation of the corporation were formally commenced by necessary filings with the state authorities on July 20. It had been the practice of the corporation to market its fruit through a local cooperative marketing association. By July 20, the cherry crop had already been delivered to the co-op and sold. The apricot crop had been delivered to the co-op prior to July 20 but had not then yet been sold. The peach crop

was delivered to the co-op and sold in September. Prior to the filing on July 20, which formally commenced the dissolution proceeding, the stockholder orally advised the co-op that the corporation was to be dissolved and directed that the apricot and peach crops be handled for his individual account. On the basis of this instruction and the fact that the accounts of the co-op were altered accordingly to show that sales of the fruit would henceforth be for the individual account of the stockholder, taxpayer contended that the profit on the sales was not attributable to the corporation.

This Court held that the cherry crop had not been distributed to the stockholder because it had been sold prior to July 20, and thus the proceeds of the sale of that crop were clearly taxable to the corporation. With respect to the apricot and peach crops, however, this Court concluded that a distribution had actually occurred and that the sale of those crops by the co-op were for the account of the stockholder and not the corporation.

The Court stated at page 579:

> "The problem here is simply whether the distribution was made."

Apparently answering the Commissioner's contention that this result was contrary to the holding in *Lynch,* the Court said at page 578-579:

> "Nor are we here concerned with an attempt of a going concern to avoid a tax on the sales of its products by the ritual of a paper transfer of such products to shareholders as dividends, followed by sales of such products in the ordinary course of the corporation's business, as in *United States v. Lynch,* 9 Cir., 192 F.2d 718."

The Court pointed out that there were two courses of action open to the stockholder, as follows (page 581):

> "He could sell the apricot and peach crops for the corporation as trustee in dissolution, through Skookum, and take the proceeds as liquidating dividends, in which event the proceeds of the sale would be taxable to the corporation, * * *"

or

> "as trustee, he could distribute the crops to himself as liquidating dividends and sell them as an individual, through Skookum, thus avoiding the tax to the corporation."

Since the stockholder chose and actually carried out the second alternative, he avoided the tax.

Lynch and *Gensinger,* taken together, clearly illustrate the error of the Government's apparent interpretation of *Lynch.*

As in *Lynch* and *Gensinger,* the question in the case at bar is the legal consequences of what was actually done, without reference to whatever tax avoidance motives or intentions that may have been involved.

To characterize the organization of Ajax, the numerous subscriptions for its stock and notes, its sizable bank borrowings, its purchase of the mortgage notes involving the presentation of formal written offers to the 68 beneficiaries of the trust which owned the mortgage notes, its pledge of the mortgage notes as security for its bank indebtedness, its collection of principal and interest on the mortgage notes, its payment of its bank loan in various installments over a period of five years, its eventual acquisition of all of Appellant taxpayer's stock from the numerous shareholders who theretofore held it, and the multitude of other transactions and functions which the

admitted facts establish it engaged in, as paper ritual without substance, would be to abandon reason. The admitted facts establish these things were actually done. Under the decisions of this Court and of the Supreme Court of the United States, the tax consequences must be determined accordingly. *Twin Oaks Co. v. Comm'r,* (9 Cir., 1950) 183 F.2d 385; *Gensinger v. Comm'r,* (9 Cir., 1953) 208 F.2d 576; *Gregory v. Helvering,* 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935); *Knetsch v. United States,* 364 U.S. 361, 5 L.Ed.2d 128, 81 S.Ct. 132 (1960).

Viewing the admitted facts on this basis, Ajax was a corporation organized by its stockholders (who were largely stockholders of Appellant taxpayer) to acquire the mortgage notes, and it did acquire them, hold them, and deal with them as an owner. The only connection or relationship of Ajax to Appellant taxpayer arises from the fact that they had substantially the same stockholders. As established by the authorities cited and discussed in Appellant taxpayer's Opening Brief, this does not justify the attribution of the purchase to Appellant taxpayer (Br. 43-47). *Koppers Co.,* 2 T.C. 152 (1943); *D. Bruce Forrester,* 4 T.C. 907 (1945).

It Was the Stockholders, Not Appellant Taxpayer, Who Determined How and by Whom the Mortgage Notes Should Be Purchased.

The Government seems to assert[3] that Appellant taxpayer somehow controlled Ajax as a parent controls its subsidiary. But Ajax was not a subsidiary of Appellant taxpayer. Appellant taxpayer owned not one share of

3. Gov't Br. 16-22, 32-34, 36-37.

stock of Ajax. Ajax was organized and controlled by its own stockholders. These stockholders comprised a substantial number of individuals and several entirely unrelated corporations. It is true that the larger portion of these stockholders were also stockholders of Appellant taxpayer. But they controlled Appellant taxpayer, not vice versa. To resort to an analogy which may illustrate the point, the fact that a brother and a sister have the same father does not make the brother a parent of the sister, or place her in his charge. The father is the parent of both children and controls each of them, but neither child controls the father or the other child. Brother/sister corporations are in the same relationship to their common stockholder, and to each other.

In the case at bar, it is stipulated that when it was determined that Appellant taxpayer should not purchase the mortgage notes, certain stockholders of Appellant taxpayer then began to explore the possibility of joining with other stockholders for the purpose of attempting to purchase the mortgage notes, and Ajax was organized for that purpose. The larger part of the stockholders of Appellant taxpayer subscribed for stock and stockholder notes of Ajax to provide a substantial portion of the funds required to purchase the notes, and Ajax proceeded to purchase the notes accordingly (R. 87-92). Complete control and ownership of Ajax was thus vested in its stockholders, and they were certainly not puppets, tools or alter egos of Appellant taxpayer which they themselves also owned and controlled. Thus, to say that Appellant taxpayer controlled Ajax, or that Ajax was a mere agent of Appellant taxpayer is simply not compatible with the stipulated facts. If Ajax was an agent of anyone, it was

the agent of its stockholders. It was the stockholders who set out to acquire the notes.

It is obvious that the ownership of Appellant taxpayer's stock must have been an important consideration in the determination of these stockholders to attempt to acquire the mortgage notes. Had they owned no interest in Appellant taxpayer, these particular persons would probably have had little interest in making this particular additional investment. But this was a decision and determination by the stockholders, as such, not of Appellant taxpayer. It had already been determined that Appellant taxpayer could not purchase the notes because the cost, plus the tax, "would be prohibitive" (R. 88). Nevertheless, as the substantial owners of the enterprise, they still desired to acquire these important outstanding securities—the mortgage notes—the holders of which were in a position to foreclose their mortgages on Appellant taxpayer's principal properties in the event of default. It is undoubtedly true that had it not been for the tax consequences, the stockholders would have preferred that Appellant taxpayer purchase the notes; and it is undoubtedly also true that their decision to purchase the notes themselves, rather than cause or permit Appellant taxpayer to do so, was dictated primarily, if not solely, by the tax considerations as the Trial Court found. But there can be no question that this alternative was freely open to these stockholders, and having selected this alternative and having proceeded to purchase the notes accordingly, employing Ajax as the vehicle for that purpose, the tax consequences must be determined by what they actually did, not by what they might have done.

Payments of Interest and Principal to Ajax Were an Affirmative Recognition of the Continued Existence of the Indebtedness Evidenced by the Mortgage Notes.

Interest on the mortgage notes was payable annually in the amount of approximately $66,000.00 per year. Prior to the purchase of the notes by Ajax in 1957, Appellant taxpayer had paid the interest as it accrued, except for the two years ended 3-31-54 and 3-31-55. Ajax purchased the notes on February 21, 1957, and on April 2, 1957, Appellant taxpayer made the regular annual interest payment for the year ended 3-31-57 to Ajax in the amount of $66,737.28. Out of the funds so received on account of this interest payment, Ajax paid $60,000.00 to the bank on May 17, 1957, to be applied in reduction of its bank indebtedness (R. 92-94; Exs. O, Q).[4] Also, in the negotiations on behalf of Ajax with the bank prior to the purchase, Mr. Bez had promised the bank that if it granted the loan to Ajax, Appellant taxpayer would make a substantial payment on the indebtedness evidenced by the mortgage notes in the near future. The Board of Directors of Appellant taxpayer, at its annual meeting May 17, 1957, with the approval of its stockholders given at their annual meeting held on the same day (Exs. AA, BB), authorized a principal payment in the amount of $400,000.00 to Ajax on the indebtedness evidenced by the mortgage notes, and this payment was made several days later. Of this sum, Ajax paid the bank $399,677.00

4. The Government now concedes (Gov't Br. 42) that the first payment of interest to Ajax was made on April 2, 1957, rather than May 17, 1957 as erroneously found by the Trial Court (R. 126). Accordingly, Ajax's first payment to the bank was not made until approximately one and one-half months after it had received its first payment from Appellant taxpayer.

in reduction of its bank indebtedness. The $400,000.00 payment to Ajax constituted a prepayment of principal on the notes (Finding of Fact No. 8, R. 126). The facts above outlined are clearly stated in the Statement of Facts in Appellant taxpayer's Opening Brief and are summarized in the argument on pages 47 and 48 thereof. These are the only funds paid out by Appellant taxpayer in connection with the transactions involved in this case prior to the regular annual interest payment for the year ended 3-31-58 (R. 94).

On the basis of these facts, the Government Brief asserts (at page 33) that the major portion of the funds used to purchase the mortgage notes was provided by Appellant taxpayer. Whatever implication may be intended by this statement is adequately refuted by the facts upon which it is based. As pointed out in Appellant taxpayer's Opening Brief (Br. 45-48), these payments of interest and principal on the notes after they were acquired by Ajax provides solid proof that all parties recognized the notes as representing a fully outstanding indebtedness of Appellant taxpayer, and dealt with them as such, including the bank which held the notes as the only collateral for its loan to Ajax.

As stated in *D. Bruce Forrester,* 4 T.C. 907 (1945) (acq. 1945 C.B. 3), where the same argument was made with reference to a similar situation (page 921):

"These payments are evidence of good faith."

Ajax' Purchase of the Mortgage Notes in 1957 Was Completely Unrelated to the Reorganization of Peninsula Packers in 1959.

Among the various catch-words with which the Gov-

ernment has attempted to characterize Ajax is the assertion that Ajax was a mere conduit.

It is true that on June 29, 1959, Ajax, which was now the sole stockholder of Appellant taxpayer, contributed the mortgage notes to the capital of Appellant taxpayer, thereby converting the full amount of its investment in the notes into an additional equity investment in Appellant taxpayer (R. 100-101). However, much water had run over the dam in the period since the purchase of the notes by Ajax more than two years before.

When Ajax negotiated for and purchased the mortgage notes in February, 1957, Appellant taxpayer had 27 stockholders and Ajax had 21 stockholders (Ex. SS). At that time, Mr. Bez, together with a corporation which he controlled, and the partnership Peninsula Packers, only owned approximately 25 per cent of Appellant taxpayer's stock (R. 95-96; Ex. S). While these holdings represented the largest single block of Appellant taxpayer's stock, the remaining 75 per cent was held by other individuals and groups, no individual or group having clear control of the company (R. 125). There is nothing in the admitted facts and nothing in the record which would indicate that there was any thought or contemplation whatsoever in 1957 that Bez and/or Peninsula Packers would, or even might, acquire all of the outstanding securities of Appellant taxpayer, or of Ajax, or of either of them. Indeed, the later events which led to this change of ownership, as disclosed by the undisputed facts (R. 97-101) themselves demonstrate that the change in ownership and the events which followed it, including the contribution of the notes to Appellant taxpayer, had no relationship to the original acquisition of the notes.

As stated in the Statement of Facts in Appellant taxpayer's Opening Brief (Br. 18-23), Appellant taxpayer's Alaskan salmon fishing operations during the 1958 season (the second season after the purchase) were relatively successful and resulted in a substantial profit. However, the immediate prospects of the elimination of salmon traps in Alaska and other problems created by Alaska statehood caused certain of the directors and stockholders of Appellant taxpayer to be pessimistic with respect to the prospects for the 1959 season. A meeting of the Board of Directors was held on January 14, 1959 in the California Club, Los Angeles, California, to consider the situation and determine the future course of the company and its business, in view of the Alaska situation (Ex. DD). Proposals to liquidate the company or to consolidate its operations with those of Peninsula Packers, which was also engaged in the salmon canning business in Alaska, were considered. However, substantial objections were raised to each of these possibilities. Two of the directors then joined in a suggestion that Mr. Bez be given an option until March 31, 1959 on all of the stock and notes of Appellant taxpayer and Ajax held by the other persons present at the meeting, on condition that no decision would be made during the period of the options to operate or not to operate Appellant taxpayer's plants for the coming season, and that Mr. Bez would not permit any substantial funds of the company to be committed for the operation of the company's plants during that time unless he was instructed to do so by the Board. All parties present at the meeting indicated that they would be willing to give such an option to Mr. Bez and that they would use their best offorts to persuade the

other security holders whom they respectively represented to join in such an option. As a result, by March 6, 1959 Mr. Bez had received options covering all of the outstanding stock and unsecured notes of Appellant taxpayer and of Ajax, except the stock and notes which he and Peninsula Packers already owned or controlled (R. 97-99).

These options were taken by Mr. Bez for the benefit of Peninsula Packers (R. 97-98) which, as above stated, was also engaged in the salmon canning business in Alaska. Peninsula Packers was a partnership, the sole partners of which were two corporations, Trans-Pacific Fishing & Packing Co. and Calvert Corporation (R. 96). Peninsula Packers and Trans-Pacific owned and operated a substantial number of fishing boats, facilities and equipment, and also owned the stock of Global Fishing Company, which was also engaged in fishing operations in Alaska (Ex. HH). As a result of a reorganization and consolidation of its other holdings and the exercise of the above-mentioned options, Peninsula Packers became the sole stockholder of The Ajax Company, The Ajax Company became the sole stockholder of Appellant taxpayer, and the bulk of the fishing operations and operating assets of the various components were transferred to Appellant taxpayer (R. 97-100; Exs. EE-JJ). The details of this reorganization are set forth on pages 20-22 of the Opening Brief.

The operation of Appellant taxpayer's expanded business required large borrowings from banks, particularly prior to and during the Alaskan fishing season, to finance its salmon pack. Large bank credits were also required in connection with the purchase of salmon packed by

others. In this connection, Appellant taxpayer was dependent upon lines of credit extended to it by its banks (R. 96). Upon the acquisition of all of the outstanding stock of Appellant taxpayer by Ajax, the banks indicated it would be desirable to eliminate the mortgage indebtedness owing by Appellant taxpayer under the mortgage notes. Consequently, on June 29, 1959, Ajax entered into a letter agreement with The Bank of California, whereby Ajax agreed to pledge all of the issued and outstanding stock of Appellant taxpayer to the bank as security for its bank loan, and the bank agreed to accept said stock as substitute collateral and release the mortgage notes from its pledge. Ajax further agreed that upon release to it of the mortgage notes, it would contribute them to the capital of Appellant taxpayer so that said mortgage indebtedness would be converted into equity capital of Appellant taxpayer. Said substitution of collateral was effected and, upon the release of the mortgage notes by the bank to Ajax, Ajax contributed the same to the capital of Appellant taxpayer as above stated. Entries were made in Appellant taxpayer's books of account to reflect the increase of its paid-in capital in the amount of the unpaid balance of the mortgage notes and a corresponding reduction in its long-term debt (R. 100-101); Exs. KK, LL).

Thus, it is a fact that the mortgage notes, which were purchased by Ajax in February, 1957, were eventually transferred to Appellant taxpayer some two years and two fishing seasons later, in June, 1959. However, it is equally clear that Ajax was not a mere conduit for the transmission of the notes.

In the sense that the term "conduit" is used by the

Government and by the authorities cited by the Government, a conduit is a mere instrumentality whereby, pursuant to a preconceived plan and interrelated steps, a mortgage note, a share of stock, or a bulldozer is transferred indirectly from one owner to its intended recipient. In such case, the interposition of the conduit merely operates to bring the transaction within some technical definition, such as that of a reorganization, or to disguise or conceal the intended end result. *Gregory v. Helvering,* 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935); *Minnesota Tea Co. v. Helvering,* 302 U.S. 609, 58 S.Ct. 393, 82 L.Ed. 474 (1938); *Griffiths v. Comm'r,* 308 U.S. 355, 60 S.Ct. 277, 84 L.Ed. 319 (1939); *Comm'r v. Court Holding Co.,* 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 981 (1945).

In the case at bar, it is apparent in the admitted facts that the final disposition of the mortgage notes as a contribution to the capital of Appellant taxpayer could not have been foreseen, much less be the result of a plan formulated at the time of their acquisition in 1957.

It is basic that for a series of steps to be treated as a single transaction, as the Government appears to contend, the steps must be mutually interdependent. *Here, such interdependence is completely absent.* The rule is well stated by the Third Circuit Court of Appeals in *AFC-Brill Motors Co. v. Comm'r,* 189 F.2d 704 (3 Cir., 1951), at page 707, as follows:

> "The Tax Court suggested in its opinion that one of the tests for determining whether a series of steps is to be treated as a single transaction for tax purposes is that of the mutual interdependence of the steps. Were the steps so interdependent that the legal relations created by one transaction would have

been fruitless without the completion of the series? The court concluded that the steps here involved did not meet this test of interdependence. We think that the court was right in considering the test an appropriate one and in concluding that the transactions involved in this case did not meet it."

"° ° °

"° ° ° we think that at the very least it must appear that the entire series of transactions has been carried out in accordance with a prearranged plan and that they are in fact component steps of a single transaction."

THE SECTION 269(a)(1) ISSUE[5]

Appellant Taxpayer Did Not Acquire Control of Ajax.

The Government blandly asserts[6] without citation of applicable authority that when persons owning in excess of 50 percent of Appellant taxpayer acquired in excess of 50 percent of the stock of Ajax, Appellant taxpayer *then* acquired indirect control of Ajax.

This assertion is a complete *non sequitur*. As observed in an earlier section of this Reply Brief (pp. 9-10), Appellant taxpayer did not own or control one single share of stock of Ajax. Ajax was owned and controlled solely by its stockholders, and, while a larger portion of these

5. The full text of Section 269(a), including both subsections (1) and (2), is set forth in Appendix A hereof, *infra*. In the case at bar, there is no claim or basis for claim that subsection (2), relating to corporate acquisitions of property of another corporation not controlled, directly or indirectly, by the acquiring corporation *or its stockholders*, has any application. First, this case does not involve the acquisition of property by one corporation from another and, second, the express stockholder control provision of subsection (2) would render the same inapplicable in any event. *Brick Milling Co.*, 22 T.C.M. 1603 at 1608 (1963); *Southland Corp. v. Campbell*, 358 F.2d 333 at 337 (5 Cir., 1966).

6. (Govt. Br. 27, 38).

stockholders were also stockholders of Appellant taxpayer, the stockholders of Appellant taxpayer controlled Appellant taxpayer, not vice versa. To state it tersely, brother/sister corporations are each controlled by common stockholders, but neither of them controls the other for purposes of application of the control provisions of Section 269(a)(1). This was made clear in *Brick Milling Co.*, 22 T.C.M. 1603 (1963).

Insofar as Appellant taxpayer is aware, there is no authority in support of the Government's indirect control argument in this case. Neither reason nor authority supports the Government position.

Nor does the case of *Southland Corporation v. Campbell*, 358 F.2d 333 (5 Cir., 1966)[7] support the Government's position with respect to this crucial point. In *Southland*, the controlling stockholders (Murchisons) of a defunct loss corporation, Caribbean, owned 44.9 percent of the stock of a profit corporation, Old Cabell's. After the possibility of a merger between the two corporations had arisen in June of 1956, the Murchisons, on July 11, 1956, by purchase increased their stockholding in Old Cabell's to 50.4 percent. Shortly thereafter, on August 17, 1956, the Murchisons contributed their controlling stock in Old Cabell's to Caribbean. On October 1, 1956, Old Cabell's was merged into Caribbean which, as the surviving corporation, then changed its name to New Cabell's and continued to carry on Old Cabell's profitable business. The taxpayer, Southland Corporation, which thereafter succeeded to New Cabell's, carried forward the 1954-1956 losses of Caribbean as net operating loss deductions from post-merger income. The commis-

7. (Govt. Br. 27).

sioner disallowed the deductions under the authority of Section 269(a) and the District Court upheld that determination. The Fifth Circuit Court of Appeals reversed. The Circuit Court quite properly noted that Section 269 (a) is applicable only "in carefully circumscribed situations" and held that since the Murchisons owned at least 50 percent of the stock of both corporations immediately prior to the acquisition of Old Cabell's assets by Caribbean, Section 269(a)(2) by its plain terms was not applicable. The basis of the Court's decision on this particular point is set forth in its footnote 7 on page 337 of the opinion as follows:

> "Section 269(a)(2), note 2 *supra,* restricts its applicability to the acquisition by one corporation of another corporation 'not controlled * * * immediately before such acquisition, by such acquiring corporation *or its stockholders.*' (Emphasis added)."

As heretofore noted, subsection (2) of Section 269(a) is not an issue in the case at bar.[8]

In addition, the Court in *Southland* further held that if, in fact, the Murchisons acquired control of Old Cabell's for the proscribed purpose, as an integral component of a unified plan to merge Old Cabell's into Caribbean and thus secure the benefit of Caribbean's operating losses to Old Cabell's, Section 269(a)(1) would apply. However, as noted by the Court, in such case the subsequent intended merger would be an absolute necessity to the application of Section 269(a)(1) because, as observed by the Court at page 337:

> "This transaction itself did not produce any tax benefit to Murchison Brothers; the further step of

8. See footnote 5, *supra.*

merging Old Cabell's with Caribbean was necessary before achieving this result."

Obviously, *Southland* is inapplicable in the case at bar. In *Southland,* the Court very carefully points out that common ownership of the two corporations, without subsequent merger of the two, would not serve to give one corporation control over the other, for the purposes of Section 269(a)(1). In the case at bar, Appellant taxpayer did not acquire one single share of the stock of Ajax, and no merger between Appellant taxpayer and Ajax has ever taken place to the present day.

It Is Appellant Taxpayer Not Its Stockholders Who Has Claimed the Deductions in Question. As Appellant Taxpayer Did Not Acquire and Was Not Acquired, Section 269(a)(1) Is Inapplicable.

Finally, the Government asserts that notwithstanding the fact Appellant taxpayer did not acquire control of Ajax and Section 269(a)(1) may be inapplicable by its terms, this Court should nonetheless render it applicable by judicial construction because Appellant taxpayer's stockholders have a "beneficial interest" in the net operating loss deductions claimed by Appellant taxpayer (Gov't Br. 39).

The Government attempts to rest this last gasp argument on this Court's decision in *Comm'r v. British Motor Car Distributors Ltd.,* 278 F.2d 392 (9 Cir., 1960), wherein this Court applied Section 129(a) of the 1939 Code to deny an *acquired* loss corporation the right to carry forward its pre-acquisition losses as deductions from its post-acquisition income. In other words, in *British Motor Cars,* this Court correctly held that the deductions, etc.,

which are disallowed by Section 269(a)(1) may be those of an acquired corporation as well as those of an acquiring corporation (or individual as the case may be).

The actual basis of this Court's decision which is conveniently ignored by the Government is found in a short passage from its opinion at page 394:

> "It is not the fact that they are stockholders which subjects them to scrutiny. Rather, it is the fact that they are the persons specified by the section: those who have acquired control of the corporation."

Thus this Court did not hold, as suggested by the Government, that Section 269(a)(1) may be extended beyond its plain terms to deny a "deduction, credit or other allowance" to a corporation, as Appellant taxpayer, which neither acquired nor was acquired.

In its Opening Brief, Appellant taxpayer demonstrated by logical argument supported by citation of applicable authorities (Br. 55-66) that by its plain terms, Section 269(a)(1) is inapplicable to the factual situation presented in the case at bar for two separate, independent reasons. First, Appellant taxpayer did not, directly or indirectly, acquire control of Ajax and Ajax did not, directly or indirectly, acquire control of Appellant taxpayer (Br. 55-61). In other words, neither Appellant taxpayer nor Ajax directly or indirectly acquired the requisite 50% stock ownership in the other. *Brick Milling Co.*, 22 T.C.M. 1603, 1610 (1963). Second, Appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed (Br. 61-66). *John F. Nutt*, 39 T.C. 231, 250 (1962), *Rev'd on another point, Nutt v. Comm'r*, 351 F.2d 452 (9 Cir. 1965); *Cromwell Corp.*, 43 T.C. 313 (1964).

For these reasons the decision of the Trial Court on the Section 269(a)(1) issue, as well as the Section 61(a)(12) issue, should be reversed.

CONCLUSION

Upon the basis of the foregoing Reply to the Government's Brief and for the reasons set forth in Appellant Taxpayer's Opening Brief, Appellant taxpayer again respectfully submits that the judgment of the Trial Court should be reversed with directions to enter judgment in favor of Appellant taxpayer.

Respectfully submitted,

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APPENDIX A

Section 269(a) of the Internal Revenue Code of 1954 (Prior to 1963 Amendment).

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX

(a) IN GENERAL—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

No. 22,354

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

TELEDYNE, INC.,

Appellant,

v.

NATIONAL LABOR RELATIONS BOARD,

Appellee.

Appeal from the United States District Court of the Northern District of California

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APPELLANT'S OPENING BRIEF

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APPENDIX

TABLE OF AUTHORITIES CITED

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APPELLANT'S OPENING BRIEF

PRELIMINARY STATEMENT

The appellee, National Labor Relations Board (hereinafter called the "Board") is an administrative agency created by the National Labor Relations Act, as amended (hereinafter called the "Act"), 29 USC § 151, et. seq., and is empowered to administer the provisions of the Act. (R. 215.)*

The appellant is an employer engaged in the manufacture and sale of semiconductor devices for industry, and the United States Government to be used for defense

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*References designated "R" are to Volume 1 of the record herein.

purposes, in interstate commerce within the meaning of Sections 2(6) and (7) of the Act [29 USC § 152(6), (7)]. (R. 215.)

The district court had jurisdiction of this matter pursuant to Section 11(2) of the Act (29 USC § 161(2)). This Court has jurisdiction to hear appeals from final orders of the district courts pursuant to 28 USC § 1291.

In 1966, the Board promulgated a rule in *Excelsior Underwear, Inc.*, 156 NLRB 1236 (1966) (hereinafter called *"Excelsior"*), requiring employers in elections directed by the Board pursuant to Section 9 of the Act (29 USC § 159) to provide the Board, for the express purpose of transmission to the union seeking to organize its employees, a list of names and addresses of such employees (hereinafter called an *"Excelsior* list").

In this case, the Board caused a subpoena duces tecum requiring production of an *Excelsior* list to be served on the appellant. The district court, under Section 11 of the Act (29 USC § 161), ordered appellant to comply with said subpoena.

It will be shown herein that whether or not the *Excelsior* rule is valid, the subpoena is unenforceable under Section 11 of the Act. It will further be shown that the *Excelsior* rule is not authorized by the Act, and is violative of constitutionally protected rights.

STATEMENT OF FACTS

On November 3, 1966, the International Association of Machinists and Aerospace Workers, AFL-CIO, Local Lodge No. 1327 (hereinafter called the "Union"), filed a petition with the 20th Region of the Board in San Francisco, California, seeking an election to establish its

majority status in a unit of the appellant's production and maintenance employees. Included in the unit are highly skilled employees, who are difficult to find and hire. The Union represents employees of companies that compete with appellant for such skilled employees, and other employees. (R. 215.)

On or about November 10, 1966, the appellant furnished to the Board a list of the names of all employees in the unit, together with their respective job classifications, for the Board to ascertain whether the petition was supported by 30% of the employees in the unit. On or about November 22, 1966, the Board informed the appellant that the petition was supported by 30% of the employees in the unit. (R. 216.)

On or about November 22, 1966, the appellant advised its employees that there was no rule prohibiting solicitation, or distribution of literature, on working time by employees, and that employees were free to discuss all aspects of unionism and to solicit their fellow employees to vote for or against the Union, on working time, so long as production was not interfered with. The appellant further advised its employees that they were free to distribute literature, for or against the Union, in nonworking areas of the plant, such as in the lunchroom and in parking lots. (R. 216.)

On November 29, 1966, following a hearing on the question of representation, the Regional Director for the 20th Region (hereinafter called the "Regional Director"), issued a Decision and Direction of Election setting the election for December 23, 1966. The Regional Director also directed the defendant to furnish him two copies of an *Excelsior* list. (R. 216.)

On or about December 2, 1966, the appellant advised its employees that they could furnish the Board with two

copies of their names and addresses, and gave them a stamped envelope addressed to the Board which they could privately use for this purpose. Appellant further advised its employees that it does not give employees' addresses to third parties without the employees' consent. (R. 217.)

On or about December 3, 1966, the appellant offered to have, at its own expense, a disinterested thirty party, such as the American Arbitration Association, receive from it the names and addresses of all eligible employees, and at any time thereafter during the pre-election period, receive from the Union its communications in stamped envelopes so that such disinterested third party could affix the names and addresses thereto and mail them to the appellant's employees' homes for the Union. The Union was advised of this offer. At no time during the period from December 3, 1966, to date, has the Union shown any interest in, or accepted said offer. (R. 217.)

On December 3, 1966, the appellant offered to prepare an alphabetical list of the names and classifications of all eligible employees, and agreed to make such list available to the Regional Director, and the Union for inspection a reasonable time prior to the election, and for use during the election. On or about December 22, 1966, at the pre-election conference held by the Board, the eligibility list of the names and classifications of all employees was made available to the Board and the Union. Such eligibility list was used by the Board in the conduct of the election on December 23, 1966. (R. 217-218.)

During the pre-election period the Union campaigned and distributed numerous communications to appellant's employees. (R. 218.)

On December 23, 1966, an election was held. The appellant won the election by a margin of 648 votes in its favor to 124 votes in favor of the Union. (29 ballots were challenged.) (R. 218.)

On December 28, 1966, the Union filed objections to the election. The Regional Director, in a Supplemental Decision and Order dated January 17, 1967, ruled that the election of December 23, 1966, be set aside and ordered that a new election be held because the appellant had not complied with *Excelsior*. A second election was scheduled for June 15, 1967. The Regional Director also issued a new order that the defendant produce an *Excelsior* list. (R. 218.)

On May 31, 1967, the Regional Director caused to be served on the appellant a subpoena duces tecum directing it to produce either an *Excelsior* list, or its personnel and payroll records. The appellant then filed, with the Board, a petition to revoke the subpoena. The petition was denied. (R. 218-219.)

The second election scheduled for June 15, 1967, was indefinitely postponed by the Board after the appellant refused to voluntarily comply with the subpoena. (R. 219.)

With respect to the second election, the appellant took the following actions, which it had already taken in the first election, to make effective means of communication available to the Union, and informed the Board and the Union thereof:

(a) It again informed the Board that its employees had the right to solicit on working time and to distribute literature for or against the Union.

(b) It offered to again furnish each employee means to privately make his name and address available to the Board and the Union.

(c) It again offered to provide, at its expense, an independent agency to mail Union communications to employees' homes.

(d) It again offered to provide a list of names of employees eligible to vote to the Board and the Union for inspection, and use, a reasonable time before the election. (R. 219.)

On September 20, 1967, the instant action was commenced to enforce the subpoena duces tecum, and on October 11, 1967, the appellant was ordered by the district court to comply therewith.

SPECIFICATION OF ERRORS

1. The district court erred in ruling that the instant subpoena duces tecum called for the production of "evidence" within the meaning of Section 11 of the Act (29 U.S.C. § 161).

2. The district court erred in ordering the appellant to comply with the subpoena duces tecum pursuant to Section 11 of the Act (29 U.S.C. § 161(2)).

3. The district court erred in holding that as applied in the instant case, the *Excelsior* rule is valid.

ARGUMENT

I. IRRESPECTIVE OF WHETHER THE *EXCELSIOR* RULE IS VALID, THE SUBPOENA IS UNENFORCEABLE BECAUSE IT DOES NOT CALL FOR THE PRODUCTION OF EVIDENCE TO BE USED BY THE BOARD.

The District Court enforced the subpoena pursuant to Section 11 of the Act (29 USC § 161). Section 11 provides, in pertinent part, as follows:

"SEC. 11. For the purpose of all hearings and investigations, which, in the opinion of the Board, are necessary and proper for the exercise of the powers vested in it by section 9 and section 10—

"(1) The Board, or its duly authorized agents or agencies, shall at all reasonable times have access to, for the purpose of examination, and the right to copy any evidence of any person being investigated or proceeded against that relates to any matter under investigation or in question. The Board, or any member thereof, shall upon application of any party to such proceedings, forthwith issue to such party subpenas requiring the attendance and testimony of witnesses or the production of any evidence in such proceeding or investigation requested in such application . . .

"(2) In case of contumacy or refusal to obey a subpena issued to any person, any district court of the United States or the United States courts of any Territory or possession, or the District Court of the United States for the District of Columbia, within the jurisdiction of which the inquiry is carried on or within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides or transacts business, upon application by the Board shall have jurisdiction to issue to such person an order requiring such person to appear before the Board, its member, agent, or agency, there to produce evidence if so ordered, or there to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by said court as a contempt thereof." (29 USC § 161.)

While Section 11 grants the Board discretion in deciding whether an investigation is necessary and proper for

the exercise of power vested in it by Sections 9 and 10 of the Act, the only subpoenas authorized by Section 11 are those which call for the production of "evidence," and are for the purpose of such a hearing or investigation.

The legislative history of Section 11 indicates legislative concern about the Board conducting a "roving commission" by subpoena, and there was a conscious effort to prevent this from occurring. II Legislative History of NLRA 2932, 2978-79, 3076 (1935); H. Rep. No. 969, 74th Cong., 1st Sess. 22 (1935); H. Rep. No. 972, 74th Cong., 1st Sess. 22 (1935); H. Rep. No. 1147, 74th Cong., 1st Sess. 25 (1935).

The present Section 11 is virtually identical with Section 11 of the original National Labor Relations Act. The purpose of said section is to give:

> ". . . to the Board in connection with those issues in which it has compulsory power (that is, the prevention of unfair labor practices and the choice of representatives . . .) the usual powers to take testimony *germane to the matter under investigation. . . .*" (Emphasis added.) (I Legislative History of the National Labor Relations Act 1935, 1108 (1935).)

The following exchange between Senator Wagner, draftsman of the original Act, and James W. Deffenbaugh, a representative of Hocking Glass Company, illustrates legislative intent to grant limited subpoena power under Section 11:

> "MR. DEFFENBAUGH: I do not believe it is fair . . . to permit quite such a wide latitude of the Board or agency to investigate any private business and make it produce all of the private records. I think the power there is too broad . . . .

> "SENATOR WAGNER: Of course, this examination you have referred to *can only be on matters which relate to the particular controversy and must be pertinent.*" (II Legislative History of the National Labor Relations Act 1935, 1891 (1935)) (Emphasis added)

Section 11 permits the Board to issue subpoenas which call for the production of "evidence". There is no definition of the word "evidence" in the Act, and when a word like "evidence" is used, it is presumed that Congress intended to use it in its technical meaning. "Legal terms in a statute are presumed to have been used in their legal sense." Sutherland, *Statutory Construction,* §4919, at 438-439, and cases cited therein (3d ed. 1943); see also, *Standard Oil Co. v. United States,* 221 U.S. 1, 59 (1910).

There is little difference between the various definitions of the word "evidence". Webster's Third New International Dictionary of the English Language (Unabridged) defines "evidence" as "something legally submitted to a competent tribunal as a means of ascertaining the truth of any alleged matter of fact under investigation before it." (p. 788) Black's Law Dictionary, Fourth Edition, defines the term as follows:

> "Any species of proof, or probative matter, legally presented at the trial of an issue, by the act of the parties and through the medium of witnesses, records, documents, concrete objects, etc., for the purpose of inducing belief in the minds of the court or jury as to their contention." (p. 656)

Corpus Juris Secundum defines "evidence" as follows:

> "Evidence broadly defined, is the means from which an inference may logically be drawn as to

> the existence of a fact; that which makes evident or plain. Evidence is the demonstration of a fact; it signifies that which demonstrates, makes clear, or ascertains the truth of the very fact or point in issue, either on the one side or on the other. In legal acceptation, the term 'evidence' includes all the means by which any alleged matter of fact, the truth of which is submitted to investigation, is established or disproved." (31 C.J.S., Evidence, Sec. 2.) (footnotes omitted)

Thus, legislative intent to provide the Board only with power to subpoena "evidence" which is relevant to the particular investigation or hearing before it is clear. Inherent in this is the requirement that the Board, itself, make independent use of such "evidence" to resolve some issue before it.

In *NLRB v. Kingston Trap Rock Co.*, 222 F.2d 299 (3d Cir. 1955), the employer contended that a Board agent might turn certain subpoenaed information over to a union. The court responded that to suspect a government agent of such a "wrongful act" was "brazen and insulting". 222 F.2d at 302.

In the most recent decision on this issue, *NLRB v. Q-T Shoe Manufacturing Co., Inc.*, ... F.Supp. ..... (D.C.N.J. 1968), the court denied enforcement of a subpoena similar to the instant subpoena, and stated:

> ". . . Nowhere do Sections 11(1) and 11(2) of the Act authorize the Board to use its investigatory and subpoena powers for the sole purpose of transmitting information to certain parties to a representation proceeding, as required by the *Excelsior* rule. The plain language of Section 11(1) of the Act would appear to indicate that there must be some independent use made by the Board itself of

evidence obtained pursuant to its investigatory powers under that section. . . ."

(A copy of said decision is attached hereto as Appendix 1)

From the above, it can be seen that a common and essential element of these definitions is that "evidence" is probative of a question of fact to be decided by some tribunal, and is used by such tribunal in resolving said issue. Indeed, the legislative history of Section 11, is consistent with this standard meaning of the word "evidence", and pursuant to the rule of construction cited above, it is the meaning that the Court must use in making a determination under Section 11.

In the instant case, the Board will not make any independent use of the *Excelsior* list but will simply turn it over to the Union for use in its organizing campaign. The appellant has furnished the Board with the names of the employees for use in connection with the election. Since there were only 29 challenges to the first election, and the Union lost the election by a margin of 648 to 124, said challenges could not affect the results of the election. Since the second election was never conducted there was no issue to resolve regarding challenges. The Board has not contended that the *Excelsior* list is needed by it to determine whether a question concerning representation exists, or to determine voting eligibility. The second election was not to be conducted by mail ballot and therefore the list was not to be used by the Board for any purpose except transmittal to the Union. This is unprecedented, and is not permitted by Section 11.

If the instant subpoena is enforced on the rationale the information will "aid" employees to make a more intelligent choice, the Court, is in effect, opening to

parties in representation proceedings, through the Board, all information which they deem helpful in organizing employees. It certainly can be argued that the employer has access to information about such matters as labor and material costs, management salaries, employees' wages, production schedules, amount of overtime worked, profits, etc., which unions do not have, and that such information would aid the employees in making a more intelligent choice. It would follow that all such information is subject to subpoena in representation cases pursuant to Section 11. Such use of Section 11 would create the evils which Congress clearly sought to prevent.

Before the district court, and in other similar cases, the Board has fallen back on the weak defense of raising and refuting a false issue. It has argued that the term "evidence" under Section 11 is not limited to formal proof of disputed facts presented in a trial-type hearing. This, however, is not in issue, in that appellant admits that subpoenas permitted by Section 11 are not limited to "trial-type hearings". What appellant contends, is that "evidence" within the meaning of Section 11, must be used by the Board, itself, and must logically be limited to facts probative to an issue before the Board.

Not only has the Board not met this essential issue, but neither has the court below, or the other courts that have enforced similar Board subpoenas.* In *NLRB v.*

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* See *NLRB v. Wolverine Industries Division, Mid-State Metal Products, Inc.*, ... F.Supp. ....., 64LRRM 2187 (E.D. Mich. 1967); *NLRB v. British Auto Parts, Inc.*, 226 F.Supp. 371 (C.D. Cal. 1967); *Swift & Co. v. Solien*, 66LRRM 2038 (E.D. Mo. 1967); *NLRB v. Wyman-Gorden Co.*, 270 F.Supp. 283 (D. Mass. 1967); *NLRB v. Beech-Nut Life Savers, Inc.*, ... F.Supp. ....., 56LC ¶ 12,237 (S.D.N.Y. 1967). Cf *NLRB v. Montgomery Ward & Co.*, ... F.Supp. ....., 64LRRM 2299, 2301 (N.D. Fla. 1967).

Hanes Hosiery Division, ... F.2d ....., 56LC ¶ 12,210, (4th Cir. 1967), petition for cert. filed, 36 U.S.L. Week 3271 (U.S. Jan. 2, 1968) (No. 982), the court stated that the *Excelsior* list was "evidence" within the meaning of Section 11, without indicating how the list was relevant to any issue before the Board.

In *NLRB v. Rohlen,* ..... F.2d ....., 56LC ¶ 12,252, (7th Cir. 1967), the court stated that the "something in issue in a representation proceeding" is employee group preference, and

> ". . . An *Excelsior* list, by facilitating a fully informed electorate, is evidence which aids in the establishment of that group preference. . . . " (..... F.2d at .....)

The court was wrong. The basic things in issue in a representation proceeding are (1) what is an appropriate bargaining unit? and (2) how did the employees vote? Additional issues may arise regarding (1) the mechanics of voting; such as when, where and how the voting should take place; (2) the overt conduct of the parties which may affect the outcome of the election; and (3) challenges to ballots that could affect the results of the election. An *Excelsior* list has no probative value on these issues in a case, such as the instant case, where (a) the list was subpoenaed after the appropriateness of the unit had been resolved; (b) there were no challenges that could affect the results of the election, and (c) there were no objections to be resolved. The court also stated that the subpoena was enforceable because it touched a matter under investigation. There is nothing in the decision indicating how the list was pertinent to the matter before the Board.

Doubtless, the Board would find it convenient, after having promulgated *Excelsior,* to enforce it in the court

pursuant to Section 11 rather than to follow its traditional course of overturning elections as a means of enforcing its rules. However, convenience to an agency is not the test. Rather, the test is the statute that Congress has enacted. Congress' will can be effectuated only by denying enforcement of the subpoena.

It is submitted that since in the instant case the Board will not make independent use of the *Excelsior* list, it does not constitute "evidence," and therefore the subpoena is unenforceable.

II. THE SUBPOENA IS UNENFORCEABLE BECAUSE THE *EXCELSIOR* RULE IS INVALID

It will be shown herein that the Board was not acting within its authority when it promulgated the *Excelsior* rule, and therefore the subpoena is unenforceable.

A. The *Excelsior* Rule Is Invalid Because It Is A *Per Se* Rule In Direct Violation Of United States Supreme Court Decisions.

The Board has held that failure to supply an *Excelsior* list is, *per se,* grounds to set aside an election. The principal vice of a *per se* rule, is that it prevents the consideration of numerous relevant factors. The following statement regarding *per se* rules clearly sets forth some of the criteria which justify the establishment of a *per se* rule:

> "The substantive justification of a per se rule must rest on the fact or assumption that the gains from forbidding the specified conduct far outweigh the losses. The magnitude of this difference, plus the administrative gains, must be enough to justify the

element of arbitrariness which is always involved. This requires, first, that the harmful effects of the practice be significant; and second, either that they depend to a great enough extent on the outlawed practice so that they cannot be easily achieved in other ways, or that such ways can be anticipated and also forestalled by per se rules." (Kaysen & Turner, *Antitrust Policy* at 143.)

These factors are not present in the instant case. Numerous elections were conducted before the *Excelsior* rule was promulgated without harmful effects, and what the Board seeks to accomplish by said rule can be easily achieved by other means. The Supreme Court in *NLRB v. United Steelworkers,* 357 U.S. 357 (1958), hereinafter called *"Nutone",* and in *NLRB v. Babcock & Wilcox Co.,* 351 U.S. 105 (1956), hereinafter called *"Babcock",* has clearly indicated that *per se* rules have no place in the field of employee representation elections under the Act. In these cases, the Court held that the Board must make a full factual determination before rendering a decision — it cannot rely solely upon the fact that an employer practice existed which *may* have had the effect of closing an avenue of communication to its employees. The Court, in both cases, held that where the Board alleges an employer has interfered with a channel through which its employees may receive information from a union seeking to organize them, it must evaluate the availability of other channels of communication.

The Supreme Court in *Nutone* rejected the Board's *per se* approach in this area with the following language:

"... The very narrow and almost abstract question here derives from the claim that, when the employer himself engages in anti-union solicitation that if engaged in by employees would constitute a viola-

tion of the rule — particularly when his solicitation is coercive or accompanied by other unfair labor practices — his enforcement of an otherwise valid no-solicitation rule against the employees is itself an unfair labor practice. *We are asked to rule that the coincidence of these circumstances necessarily violates the Act, regardless of the way in which the particular controversy arose or whether the employer's conduct to any considerable degree created an imbalance in the opportunities for organizational communication. For us to lay down such a rule of law would show indifference to the responsibilities imposed by the Act primarily on the Board to appraise carefully the interests of both sides of any labor-management controversy in the diverse circumstances of particular cases and in light of the Board's special understanding of these industrial situations. . . .*" (357 U.S. at 362-363.) (Emphasis added.)

In addition, the Court thought it highly relevant that:

"No attempt was made . . . to make a showing that the no-solicitation rules truly diminished the ability of the labor organizations involved to carry their messages to the employees. . . ." (357 U.S. at 363.)

The Court also stated that:

"The Taft-Hartley Act does not command that labor organizations as a matter of abstract law, under all circumstances, be protected in the use of every possible means of reaching the minds of individual workers, nor that they are entitled to use a medium of communication simply because the employer is using it." (357 U.S. at 364.)

The Board has improperly distinguished *Babcock* and *Nutone* by arguing that in those cases the interest in

maintaining a specific channel of communication open to employees was balanced against "the employer's significant interest in controlling the use of his property and the working time of his employees." While it is true that *Babcock* concerned the right of non-employee union representatives to enter an employer's premises, and *Nutone* concerned the right of employer to conduct activities which if conducted by the employees would have been prohibited by a lawful no-solicitation rule, the Supreme Court's basic approach to problems in this area was not in any way based on these facts. The Court's unqualified requirement was that there be a detailed examination and the balancing of the specific employer practice in question against other means of communication available to the union.

In *Excelsior,* the Board stated:

> " . . . [A]s we read *Babcock* and *Nutone,* the existence of alternate channels of communication is relevant only when the opportunity to communicate made available by the Board would interfere with a significant employer interest — such as the employer's interest in controlling the use of property owned by him. *Here, as we have shown, the employer has no significant interest in the secrecy of employee names and addresses.* Hence, there is no necessity for the Board to consider the existence of alternative channels of communication before requiring disclosure of that information. Moreover, even assuming that there is some legitimate employer interest in nondisclosure, we think it relevant that the subordination of that interest which we here require is limited to a situation in which employee interests in self-organization are shown to be substantial. . . ." (156 NLRB at 1245.) (Emphasis added.)

Even if the Board's interpretation of *Nutone* and *Babcock* is correct, its conclusion that an employer has no substantial interest in a list of employees names is clearly incorrect. However, here again, because of the application of the *per se* rule, the appellant has had no opportunity to show that it has a substantial interest in such a list.

The appellant employs a large number of highly skilled employees who are essential to its operations. It is expensive to train and hard to find employees of this type in today's labor market. The names and addresses of said employees are valuable trade secrets of the appellant. The *Excelsior* rule and the subpoena require the appellant to furnish the names and addresses of these employees to the Union which represents employees of companies that compete with the appellant in the labor market, and has regular contacts with said competitors. It is apparent the appellant has a substantial interest in non-disclosure of the *Excelsior* list to the Union. The *Excelsior* rule, without providing any protection, seriously interferes with this substantial interest of the appellant.

The appellant has a further substantial interest in not revealing the names and addresses of its employees against the employees' wishes. An employer, and its employees, are not adversaries, and both have a common interest in the conduct of the business enterprise. There were, and are, numerous employees who do not want their names and addresses given to a union. For an employer to reveal such names against an employee's wishes not only violates the employee's right, but also will have a detrimental effect on his relations with its employees.

There is still another reason why the Board's position is incorrect and naive. The Supreme Court in *Nutone* and

Babcock has recognized that an employer has a substantial interest in resisting union organization, and ruled that before this interest can be invaded a full-scale inquiry, in contrast to a *per se* rule, must be made. Indeed, the court in *Babcock* stated:

> ". . . The employer may not affirmatively interfere with organization; the union may not always insist that the employer aid organization. . . ." (351 U.S. at 112.)

An employer's substantial interest in resisting organization of its employees is also implicitly recognized in Section 8(c) of the Act (29 USC § 158(c), which protects an employer's right to make anti-union speeches.

The fact that *Nutone* and *Babcock* involved unfair labor practices does not mitigate the effect of these decisions in the instant case, which concerns a representation proceeding under Section 9 — and should make no difference in determining whether an evaluation of alternative channels of communication should take place. Indeed, the Board's position in *Nutone* was stronger than its instant position because in that case the employer engaged in unfair labor practices besides allegedly closing a channel of communication. If a *per se* rule cannot apply where there are charges of unfair labor practices, it certainly can not apply in this case, where there has been no charge of unfair labor practices or other coercive employer conduct. It would be ridiculous to hold that the opportunities for communications are balanced in an unfair labor practice case, and in the same fact situation to hold that a *per se* rule should be applied in a representation proceeding. Either the existence of alternative channels is relevant or it is not.

The Board cannot seek sanctuary in its power to conduct elections. The Board does not have a *carte blanche*

to determine election rules, any more than it has to determine unfair labor practices, as numerous court decisions have demonstrated. See, *e.g., NLRB v. Schapiro & Whitehouse, Inc.*, 356 F.2d 675, 61 LRRM 2289 (4th Cir. 1966); *Bullard Co. v. NLRB,* 61 LRRM 2670 (D.D.C. 1966). Alternative means of communications must be considered and on a case-by-case basis.

It is apparent that since the Board's primary purpose is not an adequate basis for establishing a *per se* rule, the secondary purpose of reducing the number of *possible* challenges to ballots, and *possible* challenge proceedings, is certainly not an adequate reason for establishing such a rule.

A full hearing in the instant case would have revealed that the instant subpoena was not needed by the Union to get its views to the employees, and the employees had ample opportunity to receive the Union's views through available channels of communication, and to make a free, intelligent choice in the election. The employees were specifically permitted to, and informed of their right to, solicit for the Union and to distribute Union literature *during working time* so long as such activity did not interfere with production. The employees were also furnished with stamped, addressed envelopes with which they could individually mail their names and addresses to the Regional Director for use by the Union. Furthermore, the appellant offered, at its own expense, to submit a list containing the names and addresses of all eligible employees to a neutral third party who would in turn mail to such employees any communications supplied by the Union in stamped and sealed envelopes. The Union, indicating it had no interest in mailing anything to the employees' homes, did not avail itself to this offer. If the Union had accepted, it would have been in the same position as the appellant, who mailed to the employees' homes

but could not make visitations to their homes. (The Board has ruled that home visitations are coercive when engaged in by employers. *Peoria Plastics Company,* 117 NLRB 545 (1957). Now it takes the position that union visits are not. The rationale behind this position is difficult to understand, and the inequity the Board is creating clearly is arbitrary and cannot be enforced.) Lastly, it should be noted that the Union did in fact wage a vigorous campaign which included extensive handbilling of Union literature.

Under the foregoing facts, it is impossible to say that the failure of the employer to make an *Excelsior* list available to Union interfered with the employees' free choice. There is no way for the Board to escape the mandates of *Nutone* and *Babcock,* and therefore the subpoena is invalid because it is being used to enforce an invalid *per se* rule.

B. The *Excelsior* Rule, As Applied In The Instant Case, Is Invalid Because It Violates The Constitutionally Protected Right Of Privacy.

It has been shown herein that because of the appellant's actions, the Union had all means of communication available to it, including mailing its campaign material to homes, except visits to the homes of those employees who did not wish their addresses furnished to the Union. It will be shown herein that the right to be free from intrusions into the privacy of one's home is protected by the Constitution, and that the intrusion caused by *Excelsior* is violative of this protection.

In 1928, Justice Brandeis stated:

> "The makers of our Constitution undertook to secure conditions favorable to the pursuit of happi-

> ness. They recognized the significance of man's spiritual nature, of his feelings and of his intellect. They knew that only a part of the pain, pleasure and satisfactions of life are to be found in material things. They sought to protect Americans and their beliefs, their thoughts, their emotions and their sensations. They conferred, as against the Government, the right to be let alone — the most comprehensive of rights and the right most valued by civilized men." (*Olmstead v. United States,* 277 U.S. 438, 478 (1928) (dissenting opinion))

The Supreme Court has recently defined the constitutionally protected right of privacy. *Griswold v. State of Connecticut,* 381 U.S. 479 (1965). The Court stated:

> "The . . . cases suggest that specific guarantees in the Bill of Rights have penumbras, formed by emanations from those guarantees that help give them life and substance. . . . Various guarantees create zones of privacy." (381 U.S. at 484.)

This right, which is based on the First, Fourth and Fifth Amendments of the Constitution, protects all persons from unwanted and bothersome intrusion upon their private lives. In *Griswold,* a law prohibiting the use of contraceptives was held to be a violation of the "right of privacy". That right was seen by the Court to provide "protection against all governmental invasions 'of the sanctity of a man's home and the privacies of life.' " 381 U.S. at 484, citing *Boyd v. United States,* 116 U.S. 616, 630 (1886). The instant subpoena would have the effect of exposing appellant's employees to unwanted and bothersome intrusions upon their private lives — the "sanctity" of their homes would be violated. The *Excelsior* rule is a clear instance of governmental action in violation of the constitutionally protected right of privacy.

Even before *Griswold,* the Supreme Court had occassion to comment on the sanctity of a man's home. In *Public Utilities Commission v. Pollak,* 343 U.S. 451 (1952), a majority of the Court denied the constitutional claims of those who urged that their right of privacy was being invaded when a public bus company broadcasted commercial radio programs in buses. The Court did, however, recognize the distinction between a man's home and a public bus. In denying the plaintiffs' claim, the Court said:

> ". . . [Plaintiffs'] position wrongly assumes that the Fifth Amendment secures to each passenger on a public vehicle regulated by the Federal Government a right of privacy substantially equal to the privacy to which he is entitled in his own home. *However complete his right of privacy may be at home,* it is substantially limited by the rights of others when its possessor travels on a public thoroughfare or rides in a public conveyance. . . ." (343 U.S. at 464). [Emphasis added.]

In *Pollak,* Mr. Justice Douglas, wrote a long and persuasive dissent which very closely resembles the majority opinion which he wrote for the Court in *Griswold.* Justice Douglas stated:

> ". . . Liberty in the constitutional sense must mean more than freedom from unlawful governmental restraint; it must include privacy as well, if it is to be a repository of freedom. The right to be let alone is indeed the beginning of all freedom. Part of our claim to privacy is in the prohibition of the Fourth Amendment against unreasonable searches and seizures. *It gives the guarantee that a man's home is his castle beyond invasion either by inquisitive or by officious people. . . .*" (343 U.S. at 467.) (Emphasis added)

Justice Douglas noted that the right of privacy is embodied in not only the Fourth Amendment but also the First and Fifth Amendments. In essence, he felt:

> "The present case involves a form of coercion to make people listen. . . When we force people to listen to another's ideas, we give the propagandist a powerful weapon. . . Once privacy is invaded, privacy is gone. . . The right of privacy should include the right to pick and choose from competing entertainments, competing propaganda, competing political philosophies. If people are let alone in those choices, the right of privacy will pay dividends in character and integrity." (343 U.S. at 468-469.)

Chafee, in "Free Speech in the United States" (1941), 406, believed:

> "House-to-house canvassing raises more serious problems . . . The possibilities of persuasion are slight compared with the certainties of annoyance. Great as is the value of exposing citizens to novel views, *home is one place where a man ought to be able to shut himself up in his own ideas if he desires.* There he should be free not only from unreasonable searches and seizures but also from hearing uninvited strangers expound distasteful doctrines. A doorbell cannot be disregarded like a handbill. It takes several minutes to ascertain the purpose of a propagandist and at least several more to get rid of him. . . ." (Emphasis added)

The right of privacy is intimately connected with the right against disclosure of names which has been protected by the Supreme Court, absent some compelling national or state interest in favor of disclosure. See *Tally v. California,* 362 U.S. 60, 66 (1960) (Harlan, J., concurring); *Bates v. City of Little Rock,* 361 U.S. 516

(1960); *NAACP v. Alabama Ex. Rel. Patterson,* 357 U.S. 449, 463-64 (1958); *Sweezy v. New Hampshire,* 354 U.S. 234, 265 (1957) (Frankfurter, J.) See McKay, The Preference for Freedom, 34 N.Y.U.L. Rev. 1183, 1222 (1959). There is no such compelling interest in the instant case because the Union had a substantial opportunity to communicate.

In the instant case, the only purpose of the *Excelsior* rule is to permit the union to visit the employees at their homes. There is no provision under the rule which protects employees who do not desire such contacts. While employees can refuse to accept union literature and turn their backs on union visitors, it is the right to be free from unwanted or bothersome intrusions that is protected by the Constitution, and the fact that employees can fend off intrusion is irrelevant. The *Excelsior* rule is invalid because it causes the intrusion.

In spite of the fact that the Board is acting in an area which is constitutionally protected, it has chosen to proceed on the basis of a *per se* approach. Instead of evaluating all factors to determine if an *Excelsior* list is needed by the Union to effectively communicate with employees, the Board has ruled that a list must be supplied in every case. As has been shown herein, this *per se* approach is improper under the Act. The invalidity of an all encompassing rule which infringes upon constitutional rights is clear. *Tally v. California,* 362 U.S. 60 (1960); *Cantwell v. Connecticut,* 310 U.S. 296 (1940); *Schneider v. State,* 308 U.S. 147; *Hague v. CIO,* 307 U.S. 496 (1939); *Lovell v. City of Griffin,* 303 U.S. 444 (1938).

The appellant has standing to raise this issue of deprivation of the constitutionally protected right of privacy. The average employee has no effective means of enforcing said right against the intrusion directly caused by

Excelsior. Most employees are unaware of the rule. They are not parties to representation proceedings and therefore their constitutional rights will be infringed upon without notice. In addition, an individual employee not only must bear the expense of retaining an attorney and fighting a lengthy and costly battle with the Board, he must also single himself out among his fellow employees as a person who does not support, or want to have any contacts with, the union. The instant situation is similar to the one in *Barrows v. Jackson,* 346 U.S. 249 (1953), where the court stated:

> ". . . [W]e are faced with a unique situation in which it is the action of the state court which might result in the denial of constitutional rights and in which it would be difficult if not impossible for the persons whose rights are asserted to present their grievance before any court. Under the peculiar circumstances of this case, we believe the reasons which underlie our rule denying standing to raise another's rights, *which is only a rule of practice,* are outweighed by the need to protect the fundamental rights which would be denied by permitting the damages action to be maintained." (346 U.S. at 257.) (Emphasis added)

The Board, by the *Excelsior* rule, has made the appellant its instrumentality to effectuate an unconstitutional invasion of employees' privacy. Thus, it is clear that the appellant has standing to assert the constitutional rights of its employees, and refuse to be such an instrumentality.

The appellant's standing to assert this matter has been recognized by the Supreme Court. *Gibson v. Florida Investigating Committee,* 372 U.S. 539 (1963); *Bates v. City of Little Rock,* 361 U.S. 516 (1960); *NAACP v. Alabama,* 357 U.S. 449 (1958); *Barrows v. Jackson,* 346

U.S. 249 (1953); *Pierce v. Society of Sisters,* 268 U.S. 510 (1924).

The Court in *NAACP v. Alabama, supra,* was concerned with the effect disclosure of membership lists would have upon the exercise of freedom of association. The probability of interference with an employee's constitutional right of privacy is surely as great as a result of the *Excelsior* rule, as the probability of interference with freedom of association was by disclosure in *NAACP v. Alabama, supra.*

It is submitted that by permitting each of its employees to decide for himself whether he wanted the Union to have his name and address, the appellant did all it could constitutionally be required to do, and that therefore the subpoena is unenforceable.

C. The *Excelsior* Rule Is Invalid Because It Was Promulgated Without Publication In The Federal Register, As Required By The Administrative Procedure Act (5 USC § 1003, et seq.)

The relevant statutory provisions concerning the procedure an administrative agency must follow in promulgating rules are set forth in Sections 3(a) and 4(a) of the Administrative Procedure Act, 5 USC §§ 1002(a), 1003(a) (1964).

Section 2(c) of the Administrative Procedure Act, 5 USC § 1001(c) (1964), defines a rule to mean:

> "... the whole or any part of any agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy. . . ."

From the statutory language itself, the general plan of Congress is clear. It intended that agencies make public through the Federal Register proposed rule making and adopted rules, and that specific sanctions would exist to enforce the notice requirements.

The Board, in *Excelsior,* has adopted a rule within the meaning of Section 2(c) of the Administrative Procedure Act, *supra.*

When the Board found that *Excelsior* presented "a question of substantial importance in the administration of the National Labor Relations Act", it directed the parties to focus upon the question of providing names and addresses to the union before rendering its decision. The Board further invited certain interested parties to file *amicus curiae* briefs and to participate in all arguments. Then, in announcing the *Excelsior* policy, the Board said, "we now establish a requirement that will be applied in all election cases." 156 NLRB at 1239. It set out the procedures that are to be followed for the implementation of this policy and provided that if they are not complied with this would mean the setting aside of an election. It noted:

> "However, the rule we have here announced is to be applied prospectively only. It will not apply in the instant cases, but only in those elections that are directed, or consented to, subsequent to 30 days from the date of this Decision. We impose this brief period of delay to insure that all parties to forthcoming representation elections are fully aware of their rights and obligations as here stated." (*Id.* at 1240, n. 5.)

Thus, the Board acknowledged that it was making a rule, deliberately made it broadly applicable to future cases, and clearly did not apply it to the facts before it.

Clearly, the Board's *Excelsior* is a "rule", adopted by rule making. Since this is the case, the Board had to comply with §§ 3 and 4 of the Administrative Procedure Act.

The Board failed to comply with Section 4(a) of the Administrative Procedure Act by failing to publish a general notice of its then proposed *Excelsior* rule in the Federal Register. In addition, it then failed to comply with Section 3(a) of the Administrative Procedure Act by failing to publish the rule in the Federal Register. The Ninth Circuit Court of Appeals, in *Hotch v. United States,* 212 F.2d 280 (9th Cir. 1954), quoted the following legislative history:

> "'. . . In the 'rule making' (that is, 'legislative') function it [the Administrative Procedure Act] provides that with certain exceptions agencies must publish notice and at least permit interested parties to submit their views in writing for agency consideration *before the issuance of general regulations* . . . [italics ours].' U.S. Code Congressional Service, 79th Congress, Second Session, 1946, p. 1195, at 1205." (212 F.2d at 282.)

The court then noted that in the particular facts before it, neither notice of proposed rule making nor publication of the adopted rule had been performed by the agency. It asserted that both were necessary prerequisites to the effective issuance of a regulation, and that "if a rule has not been issued, it has no force as law." (212 F.2d at 284.)

The failure of the Board to so publish removes the duty of the appellant to comply with the *Excelsior* rule, and precludes the Court from enforcing the subpoena. *Hotch v. United States,* supra. In a more recent case, *Gonzales v. Freeman,* 334 F.2d 570 (D.C.Cir. 1964),

the court refused to enforce an agency rule because of the agency's failure to comply with the publication requirements of the Administrative Procedure Act.

In *NLRB v. Majestic Weaving Co.,* 355 F.2d 854 (2d Cir. 1966), the court criticized the Board for failing to live up to its obligation under the Administrative Procedure Act. It said the Board ought to take the hint of the Supreme Court in *SEC v. Chenery,* 332 U.S. 194 (1947), in the exercise of its important power of prospective rule making, and that it ought to do it in accordance with the requisites of the Administrative Procedure Act.

It is true that the Board may well adopt the same rule as it has, if it goes through the motions of another rule-making proceeding following proper notice. However, if defendant, and employers generally, not merely the selected representative groups who had been invited before, were able to participate or at least send their views to the Board, then the Board might be induced or inclined to feel differently about the matter.

Therefore, the *Excelsior* rule should be set aside to avoid prejudice, not only to the appellant, but also to others in its position, who were not apprised of the impending rule formulation in the manner that Congress so intended.

III. IRRESPECTIVE OF WHETHER OR NOT THE *EXCELSIOR* RULE IS VALID, THE APPELLANT HAS SUBSTANTIALLY COMPLIED THEREWITH AND THEREFORE THE SUBPOENA IS UNENFORCEABLE.

The Board has very recently stated:

> ". . . we find nothing in our Decision in *Excelsior* which would require the rule stated therein to be mechanically applied. . . ." (*Program Aids Company, Inc.,* 163 NLRB No. 54 (1967).)

The rule that *Excelsior* should not be applied mechanically was also upheld by the Board in *Valley Die Cast Corp.,* 160 NLRB No. 142 (1966). However, irrespective of the validity of *Excelsior,* it is apparent that the Board has violated its own decisions, and applied *Excelsior* mechanically in the instant case.

The alleged purpose behind such rule is to provide an atmosphere in which employees will have maximum opportunity to make an informed choice in representation elections. The appellant has done more than is required by the rule with respect to giving the Union an opportunity to have its views reach the employees.

It is therefore submitted that while the appellant has not complied with the letter of the *Excelsior* rule, it has more than substantially complied with the spirit and purpose of the rule, and for this reason the subpoena is unenforceable.

CONCLUSION

For the reasons hereinabove set forth, the Court should reverse the decision to the lower court, and order the instant action dismissed.

Respectfully submitted,
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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

SEYMOUR SWERDLOW

Seymour Swerdlow

APPENDIX I

DECISION OF U.S. DISTRICT COURT, DISTRICT OF NEW JERSEY, IN CASE OF NLRB v. Q-T SHOE MANUFACTURING CO., INC., ET AL.

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

CIVIL ACTION NO. 140-67

National Labor Relations Board

Plaintiff

vs.

Q-T Shoe Manufacturing Co., Inc. and
Martin S. Nadler as President of
Q-T Shoe Manufacturing Company, Inc.

Defendants.

OPINION

COOLAHAN, District Judge:

This matter came before the court upon the complaint of the National Labor Relations Board (hereinafter referred to as "Board"), seeking enforcement of a subpoena *duces tecum* directed to defendant Martin S. Nadler as President of Q-T Shoe Manufacturing Company, Inc., (hereinafter refered to as "Q-T Shoe"), or in the alternative a mandatory injunction compelling defendant Q-T Shoe to produce the same material sought under the subpoena *duces tecum*. Jurisdiction of this court is involved under 28 U.S.C. § 1337 and Sections 9(c) and 12 (2) of the National Labor Relations Act (hereinafter referred to as "the Act"), 29 U.S.C. §§ 159(c), 161 (2).

The material facts are as follows: The Board is an administrative agency created under the Act and empowered and directed to administer the provisions of that statute, including investigation of questions pertaining to employee representation and representation elections under Section 9 of the Act, 29 U.S.C. § 159. Q-T Shoe is an employer engaged in the manufacture of shoes in interstate commerce within the meaning of the Act, 29 U.S.C. § 152 (6), (7). The company's plant in question is located within this judicial district, at Patterson, New Jersey.

On September 20, 1966, Joint Council No. 3 of the United Shoe Workers of America AFL-CIO (hereinafter referred to as "Union"), petitioned the Board's regional office at Newark, New Jersey for a representation election to establish its alleged majority support by the employees at the Paterson Plant, and to obtain certification as their collective bargaining representative.

The regional office conducted an investigation of the petition and a hearing was held on the question of representation. Thereafter, on November 25, 1966, the Regional Director issued a Decision and Direction of Election pursuant to Section 9(c) (1) of the Act, 29 U.S.C. § 159(c)(1), which directed that an election be held for a unit of approximately 250 production and maintenance employees at the plant. The election was to be conducted by the Board and in accordance with the National Labor Relations Act, the Board's Rules and Regulations, and the applicable procedure and policies of the Board.

Pursuant to the Board's rule in *Excelsior Underwear, Inc.,* 156 N.L.R.B. No. 111 (1966), the Board ordered Q-T Shoe to furnish it with a list of names and addresses of all employees eligible to vote in the election. On December 2, 1966, Q-T Shoe notified the Board's Regional Director that it would not comply. By letter of December 5, 1966, the Union notified the Director that it did not want to proceed to election until the information was furnished. Thereafter, the Regional Director issued the instant subpoena *duces tecum* on December 19, 1966, pursuant to Section 11(1) of the Act, 29 U.S.C. § 161(1).[1]

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[1] Section 11 of the Act, 29 U.S.C. § 161, provides that:

> For the purposes of all hearings and investigations, which, in the opinion of the Board, are necessary and proper for the exercise of the powers vested in it by sections 159 [Section 9, "Representatives and Elections"] and 160 [Section 10, "Prevention of Unfair Labor Practices"] of this title—
>
> (1) The Board, or its duly authorized agents, . . . shall at all reasonable times have access to, for the purpose of examination, and the right to copy any evidence of any person being investigated or proceeded against that relates to any matter under investigation or in question. The Board, or any member thereof, shall upon application of any party to such proceedings, forthwith issue to such party subpenas requiring

The subpoena directed the defendant Martin Nadler, President of Q-T Shoe, to produce and make available to the Board's regional office the company's personnel and payroll records, or alternatively a list of all employees eligible to vote in the election. It was personally served upon Mr. Nadler on December 19, 1966.

Although Section 11(1) of the Act, *supra,* and Section 102.31(b) of the Board's Rules and Regulations, 29 C.F. R. 102.31(b), provide for a period of 5 days after service of the subpoena within which any person served who wishes to object may petition the Board to revoke the subpoena. Nadler did not file such revocation petition within five days. Further, Nadler did not appear on December 28, 1966, the return date of the subpoena, and has at all times refused to produce the materials called for therein. Consequently, the Board seeks judicial enforcement by this court of the subpoena *duces tecum,* pursuant to Section 11(2) of the Act, 29 U.S.C. § 161(2).[2]

> the attendance and testimony of witnesses or the production of any evidence in such proceeding or investigation requested in such application. Within five days after the service of a subpena on any person requiring the production of any evidence in his possession or under his control, such person may petition the Board to revoke, and the Board shall revoke, such subpena if in its opinion the evidence whose production is required does not relate to any matter under investigation, or any matter in question in such proceedings, or if in its opinion such subpoena does not describe with sufficient particularity the evidence whose production is required.

[2] Section 11(2), 29 U.S.C. § 161(2), provides in its pertinent parts:

> In case of contumacy or refusal to obey a subpoena issued to any person, any district court of the United States . . . within the jurisdiction of which the inquiry is carried on or within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides or transacts business, upon

The Board alleges that the information sought by the subpoena constitutes evidence relevant to a Board investigation within the meaning of Sections 11(1) and 11(2) and that therefore this court should direct the defendants' compliance.

As an alternative to the requested subpoena enforcement, the Board seeks a mandatory injunction directing divulgence of the names and addresses, on the ground that under 28 U.S.C. § 1337 this court has jurisdiction over actions brought by the Board to enforce valid election rules in effectuation of the policies of the Act.[3] It is the Board's position that this provision vests this court with the power to grant it injunctive assistance in the Board's effort to carry out its authorized duty of supervising elections, despite the absence of any express grant of power to the Board to request injunctive relief for this purpose under the Board's enabling legislation.

The defendants have presented several separate defenses to the complaint, and, in addition, have moved to add as further defendants the approximately 250 employees whose addresses are sought by the Board. I am of the opinion, however, that the motion should be denied and the issues raised by the parties to the present proceeding should be resolved. In making such a ruling, the

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application by the Board shall have jurisdiction to issue to such person an order requiring such person to appear before the Board, its members, agent, or agency, there to produce evidence if so ordered, or there to give testimony touching the matter under investigation or in question. . . ."

[3] Section 1337 provides that:

The district court shall have jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies.

question for the court to determine is whether the employees "[claim] an interest relating to the subject of the action and [are] . . . so situated that the disposition of the action in [their] . . . absence may . . . as a practical matter impair or impede [their] . . . ability to protect that interest. . . ." Rule 19, Federal Rules of Civil Procedure. Defendants contend that the disclosure of the employees' addresses arguably violates their right of privacy under the Due Process Clause of the Fifth Amendment of the Constitution, since to provide the Union with the addresses will subject them to the dangers of harassment and coercion in their homes. In disposing of the defendants' motion, however, it is not necessary for the court to reach the merits of the constitutional right asserted above, or the specific grievance from which the alleged constitutional right arises. Rather, the court need only inquire into the question of whether the disposition of the present action in the absence of the employees will effectively preclude them from protecting their interests later on. The court is of the opinion that this question must be answered in the negative. Whatever the outcome of the present proceeding, and whether or not disclosure of the employees' addresses to the Union in and of itself violates the employees' right of privacy, the employees will be free in the future to petition the Board for a remedy to prevent any alleged harassment and coercion by the Union resulting from such disclosure. Defendants' motion is therefore denied.

My ruling above settles neither the question whether the Board's act of supplying the Union with a list of the employees' addresses violates the employees' constitutional rights, nor whether the defendants have standing to assert such rights. These questions are taken up in a later portion of the court's opinion.

I.

Prior to considering the Board's application for enforcement of its subpoena *duces tecum,* it would be helpful to briefly review the background of the *Excelsior* rule, the particular rule in dispute. As has been adverted to earlier, it emanates from the Board's decision in *Excelsior Underwear Inc.,* 156 N.L.R.B. No. 111 (1966). Under the *Excelsior* rule, an employer must furnish the Regional Director with a list of names and addresses of all employees eligible to vote in the election, within 7 days after the Regional Director's approval of the election agreement or after the close of the determinative payroll period for eligibility purposes, whichever is later. The list is to be given to all parties, specifically including the union, in order to promote and maximize communication of election issues to the employees and also to aid in challenging possibly ineligible voters. The rule further provides that an employer's failure to file the required list of employees' names and addresses "shall be grounds for setting aside the election whenever proper objections are filed." *Excelsior Underwear, supra* at 5.

It is now essential to turn to the problem of whether a federal district court, pursuant to Section 11(2) of the National Labor Relations Act, 29 U.S.C. § 161(2), may enforce a Board-issued subpoena directing the employer to produce the list of names and addresses required by the *Excelsior* rule. The answer to this question does not turn on the validity of the rule itself, but rather, on whether the information sought by the Board is "not plainly incompetent or irrelevant to any lawful purpose. . . . " *Endicott Johnson Corp. v. Perkins,* 317 U.S. 501, 509 (1943). "The control of the election proceeding, and the determination of the steps necessary to conduct that election fairly . . . [are] matters which Congress entrusted to the Board alone." *NLRB v. Waterman S. S. Corp.,*

309 U.S. 206, 226 (1940). The purpose behind the Board's passage of the *Excelsior* rule was to make certain that employees are able to exercise an informed and reasoned choice after hearing all sides of the question concerning the desirability of Union representation, and to facilitate the process of investigating challenges to voter eligibility.

Keeping in mind the holding of the *Waterman* case, it cannot be said that the Board's purpose for seeking the information herein is an unlawful one.

Defendants contend, however, that the subpoena should not be enforced because it seeks information the disclosure of which is required by a rule which was not formulated in accordance with the rule-making requirements specified in Section 3(a) (3) and (4) of the Administrative Procedure Act, 5 U.S.C. §§ 552 (a) (3), 553. The short answer to this objection, however, is that the Administrative Procedure Act permits the Board to proceed by either rule-making or adjudication. See *SEC v. Chenery Corp.*, 332 U.S. 194, 201-203 (1947). Moreover, in determining whether a subpoena should be enforced under Section 11 of the National Labor Relations Act, the court is of the opinion that the preceding conclusion is not weakened by the fact that the *Excelsior* rule was given a prospective application by the Board.

Defendants further assert that the subpoena should not be enforced for the reason that the disclosure of the employees' names and addresses required by the *Excelsior* rule is an unlawful abridgment of the employees' right of privacy under the Fifth Amendment of the Federal Constitution. The court will assume, but does not decide, that the defendants have standing to raise this question on behalf of the employees.

The right of privacy has been the subject of very recent and prolonged debate. See, e.g., *Lamont v.*

Comm'r of Motor Vehicles, ... F. Supp. ..... (S.D. N.Y. 1967); *Symposium on the Griswold Case and the Right of Privacy,* 64 Mich. L. Rev. 197 (1965). The court's investigation of several authorities indicates that there is no decision squarely on point with the facts of the present case. The Board relies heavily on *Martin v. City of Struthers,* 319 U.S. 141 (1943), for the proposition that, assuming that the Union intends to utilize the aforementioned list of names and addresses for the purpose of conducting door to door campaign solicitations, any interest the employees may have in preventing such a practice can only be preserved by their legally protected right to turn members of the Union away from their doors. The decision in *Struthers,* however, is inapposite. In that case, the Supreme Court struck down a local ordinance prohibiting door-to-door canvassing, on the ground that, on balance with the first amendment right relied upon by the defendant, the privacy right supported by the statute must fail. In the present case, the weighing to be done, in contrast, is between the privacy right and a statutorily based right given to labor unions to seek employee support, and the *Struthers* decision is no support for the plaintiff's position.

The decision in *Breard v. Alexander,* 341 U.S. 622 (1950), cited by the defendants, is not, in the court's opinion, an authority having any direct bearing on the resolution of the immediate issue. The *Breard* case involved an ordinance prohibiting commercial solicitation from door-to-door without previous permission of home owners. In upholding the constitutionality of the ordinance, the Supreme Court ruled merely that the community's attempt to restrict one form of commercial activity was a valid measure under the police power and not a violation of due process. There is no basis upon which it can be argued that the *Breard* opinion affords

constitutional protection for the interest asserted on behalf of the employees in the present case.

Public Util. Comm'n v. Pollak, 343 U.S. 451 (1952), is more in point. There, the United States Supreme Court, considering the question of whether commercial radio broadcasting to captive audiences in publicly franchised buses and street cars was an unwarranted and unconstitutional intrusion upon the privacy of unwilling listeners who use public transportation, concluded that no right of privacy was violated. It is quite possible that the holding of this case precludes, a *fortiori,* any conclusion in the present case that the employees' right to privacy would be violated by the divulging of their names and addresses, for the captive circumstances faced by the employees in the present case are not comparable, from the point in view of *degree of captivity,* with those faced by the bus riders in Pollak, since the employees here have a legally enforceable right to remove unwanted intruders from their homes. On the other hand, it could be argued that the *quality* of the violation of the right to privacy is greater in the present case, where it is the security of the home which may be possibly violated, as opposed to the tranquility of the bus ride. There is no need, however, to finally determine the right of privacy question here, in view of the court's determination of the other issues before it, which will follow.

Having decided that the Board's issuance of the subpoena was lawful within the meaning of *Endicott Johnson, supra,* because it was based on a reasonable policy determination within the purview of the Board's powers, question still remains as to whether this court has jurisdiction pursuant to Section 11(2) of the Act, 29, U.S.C. § 161(2), to order the defendants to produce the previously referred to list of names and addresses. Resolution of this issue depends on whether, within the

meaning of Section 11(1) of the Act, 29 U.S.C. § 161(1), the Board is seeking *"for the purpose of examination . . .* evidence . . . *that relates to any matter under investigation or in question."* A representation proceeding conducted by the Board pursuant to Section 9 of the Act, 29 U.S.C. § 159, is certainly an "investigation" within the meaning of Section 11(1), the object of which is to determine the appropriate bargaining unit for a given group of employees. *Inland Empire Council v. Willis,* 325 U.S. 697, 707 (1944). The direction of an election is merely an intermediate step in the investigation, certification being the final and effective act. *Labor Board v. International Bhd. of Elec. Workers,* 308 U.S. 413, 414 (1939).

The Board argues that the employees' names and addresses are properly classified as evidence relating to a matter under investigation to the extent that the list will be utilized by the *Union* for the purpose of communicating election issues and handling challenges to voter eligibility. This is not so. [Nowhere do Sections 11(1) and 11(2) of the Act authorize the Board to use its investigatory and subpoena powers for the sole purpose of transmitting information to certain parties to a representation proceeding, as required by the *Excelsior* rule. The plain language of Section 11(1) of the Act would appear to indicate that there must be some independent use made by the Board itself of evidence obtained pursuant to its investigatory powers under that section.] Nor does the court regard *FCC v. Schreiber,* 381 U.S. 279 (1965), or *NLRB v. Friedman,* 352 F.2d 545 (3d Cir. 1965), as being dispositive of the issue.

The facts of the present case are distinguishable from those presented in both the *Schreiber* and *Friedman* cases, in that here the Board is seeking to act as a mere conduit of the information to the Union. Although the

court is of the opinion that it is proper for the Board to have the names of all employees of Q-T Shoe, so that those entitled to vote be properly identified, judicial enforcement of the Board's subpoena in the present case would effectively result in the enforcement of the *Excelsior* rule itself; it was certainly not the intention of Congress under Section 11 (2) to confer jurisdiction upon federal courts for the disguised purpose of enforcing the Board's rules of decision. Whether the *Excelsior* rule should be enforced is a separate question which is governed by other considerations, to which the court presently turns.

II.

In the alternative to its request for subpoena enforcement, the Board seeks a mandatory injunction directing the defendants to file the list of employees' names and addresses with the Regional Director, in compliance with the Board's *Excelsior* rule. Jurisdiction of the court is invoked under 28 U.S.C. § 1337, which vests district courts with jurisdiction "of any civil action or proceeding" arising under any Act of Congress "regulating commerce or protecting trade and commerce against restraints and monopolies." The Board argues that this provision empowers this court to issue an injunction, enforcing the *Excelsior* rule, despite the absence of any express grant of district court jurisdiction under the Board's enabling act. That the present suit is a "civil action or proceeding" arising under an Act of Congress "regulating commerce," cannot, of course, be denied. *Capital Service Inc. v. NLRB,* 347 U.S. 501 (1954). The pivotal question to be determined, however, is whether provisions of the Act authorizing federal courts to enforce certain orders issued by the Board themselves deprive this court of jurisdiction of the present suit. Stated

differently, does the Act itself impliedly preclude the judicial enforcement of decisions rendered by the Board pursuant to its power under Section 9 to conduct representation proceedings? This requires some discussion.

Under the Act, the Board is given the task of performing two principal functions. The first, under Section 9, is the certification of an appropriate bargaining unit of employees; the second, under Section 10, is the prevention of unfair labor practices enumerated in Section 8. Section 9 (c) authorizes the Board to conduct an investigation upon the filing of a representation petition, and, if the Board finds that a question of representation exists, to direct an election by secret ballot and certify the results. In addition, the Board is responsible for the implementation of those steps necessary to conduct the election. See *Waterman v. NLRB, supra.* Section 9, complete in itself, contains no provision for the court enforcement of a Board order issued pursuant to that section. Section 9(d) states, however, that whenever an order of the Board is made pursuant to Section 10(c) directing any person to cease an unfair practice, and there is a petition for enforcement of the order by a court, the Board's "certification and the record of such investigation" is to be included in the transcript of the entire record required to be filed under Section 10(e), and the decree of the court enforcing, modifying, or setting aside the order of the Board is to be made and entered upon the pleadings, testimony, and proceedings set forth in the transcript.

The statutory procedure for the prevention of unfair labor practice is found in Section 10 of the Act. Section 10(a) authorizes the Board to prevent persons from engaging in unfair labor practices. Section 10(b) lays down the procedure by the Board when any person is charged with engaging in an unfair labor practice. If, as a result of the proceedings conducted pursuant to 10

(b), the Board is of the opinion that the person so charged has engaged in an unfair labor practice, Section 10(c) empowers the Board to issue an order directing that person to cease the particular practice. Section 10 (e) is a provision which authorizes the Board to petition the appropriate federal court of appeals for the enforcement of its order prohibiting an unfair labor practice.

Whether this court has jurisdiction to enforce the Board's *Excelsior* rule depends on the construction and meaning to be given to Sections 9(d) and 10(e) of the Act. A fair reading of these two sections leads the court to conclude that Congress has authorized federal courts to enforce Section 9 orders of the Board only where such an order serves as the basis for the court enforcement of a Board order restraining an unfair labor practice. This follows implicitly from the fact that: 1) only Section 10 of the Act permits the Board to seek court enforcement of its orders; 2) Section 9 orders *have* been made judicially enforceable, under the Act, when they are part of a record under Section 10, and sought to be enforced for the purpose of preventing unfair labor practices. One can only conclude, in attempting to glean congressional intent in the case of a thoroughly written and far-reaching statute such as the National Labor Relations Act, that Congress meant what it said, and only what it said, and intended to exclude what it did not say. Thus, enforcement of the *Excelsior* rule can only occur after it has been properly determined by the Board that the refusal by the defendant to provide the Union with a list of its employees' names and addresses constitutes an unfair labor practice under Section 8(a)(1) of the Act, 29 U.S.C. § 158(a)(1).

The Board argues, however, that it should not at this time be compelled to find that such a refusal by the defendants violates Section 8(a)(1) of the Act. More

specifically, it insists that the standards evolved by the Board for purposes of the regulation of elections under Section 9 differ considerably from those standards utilized to administer the unfair labor practice provisions of the Act. Thus, the Board contends that the defendants' non-compliance with the *Excelsior* rule, while improper conduct during the pendency of a representation proceeding, might not be conduct sufficient to constitute an unfair labor practice. Assuming the correctness of this argument, I am of the opinion that it should be addressed to Congress and not to this court. The distinction urged by the Board does not appear to be one which Congress has recognized under Sections 9(d) and 10(e) of the Act. These sections, as interpreted by this court, confer jurisdiction upon Federal Courts of Appeals to enforce a Board order regulating the conduct of a representation proceeding only insofar as it forms the basis of an enforceable order issued pursuant to Section 10(c) of the Act.

I am therefore of the opinion that this court is without jurisdiction to enforce the *Excelsior* rule, and plaintiff's request for a mandatory injunction is denied.

Let an appropriate order be submitted.

No. 22,354

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

TELEDYNE, INC., APPELLANT

v.

NATIONAL LABOR RELATIONS BOARD, APPELLEE

ON APPEAL FROM A JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLEE

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I N D E X

AUTHORITIES CITED

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Miscellaneous: Page

IN THE UNITED STATES COURT OF APPEALS
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v.

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ON APPEAL FROM A JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLEE

JURISDICTIONAL STATEMENT

This case is before the Court on appeal from an order (R. 223-224)[1/] of the United States District Court for the Northern District of California. That Court, per the Honorable Stanley A. Weigel, United States District Judge, granted the Board's application pursuant to Section 11(2) of the National Labor Relations Act (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151 et seq.) for enforcement of a subpena duces tecum directed to Teledyne, Inc. (the "Company"). The district court declined to rule on the Board's alternative theory contained in Count II of the Complaint that the district court could grant injunctive relief under 28 U.S.C. Sec. 1337, to aid administrative agencies in pursuance of their statutory

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1/ "R" refers to the transcript of record.

[illegible]

functions. The jurisdiction of this Court is invoked under 28 U.S.C. Sections 1291 and 1294.

COUNTERSTATEMENT OF THE CASE

A. Proceedings before the Board

On November 3, 1966, the Union[2/] filed a petition with the Board's Twentieth Region in San Francisco, California, seeking to represent a unit of the production and maintenance employees at the Company's Mountain View, California, plant (R. 215).

After a hearing was held on the Union's petition, the Regional Director for the Board's Twentieth Region issued a Decision and Direction of Election. An election date was set for December 23, 1965, and the Company was ordered to furnish the Regional Director with a list of names and addresses of its employees eligible to vote within seven days after the date of the Decision and Direction of Election. The Company, however, on December 3, 1966, refused to furnish the Board with the names and addresses.

The election was conducted as scheduled, and the Union lost. The vote was 124 to 648, with 29 ballots challenged and uncounted. The Union thereupon filed an objection to the conduct of the election based upon the Company's failure to provide the list of the employees' names and addresses (R. 218). The Company opposed the objection, challenging the validity of the Board's rule requiring that the employer produce such a list on a number of statutory and constitutional grounds, and asserting that in any event, the instant election could

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2/ International Association of Machinists and Aerospace Workers, AFL-CIO, Local Lodge No. 1327.

Function: ...

Sections: ...

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not properly be set aside because the Union had ample opportunity to communicate with the employees at the plant and (through the mails) at their homes (R. 10-11, 73-78). The Regional Director rejected the Company's arguments, set the election aside on the basis of the above-stated objection, and directed that a rerun election be held (R. 9-13). Again, the Company was directed to supply a list of the eligible employees' names and addresses (R. 12).

The Company unsuccessfully sought to obtain Board review of the Regional Director's Decision and Direction of Second Election (R. 13, 85-93), and then refused to furnish the required list prior to the second election (R. 3). Because of the Company's refusal to produce the list, the election was indefinitely postponed pending proceedings to compel its production (R. 3).

On May 31, 1967, the Regional Director caused a subpena duces tecum to be served on the Company directing it to produce its books and records or, in the alternative, a list containing the names and addresses of its employees eligible to vote in the election (R. 16). The Company petitioned the Board to revoke the subpena, asserting substantially the same grounds raised here (R. 110-115). The Board denied the petition to revoke on June 12, and when the Company still refused to comply, the election was indefinitely postponed and this proceeding was initiated (R. 3-4, 218-219).

B. Proceedings in the District Court

The complaint filed by the Board in the court below sought enforcement of the Board's subpena or, alternatively, a mandatory injunction directing the Company to comply with the Board's election rule that in every election arising under Section 9 of the Act,

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the employer must supply to the Board a list of the names and addresses of all employees eligible to vote in the election, for the use of all parties to the election (R. 1-5). The District Court, on October 11, 1967, issued findings of fact and conclusions of law enforcing the subpena, and declined to rule on the Board's alternative request for a mandatory injunction directly enforcing the Board's election rule (R. 214-222). Accordingly, on the same date, an order was entered requiring the production of the documents sought (R. 223-224).

ARGUMENT

I. INTRODUCTION

On November 29, 1967, this Court granted the Board's motion to schedule the oral argument in the instant case and the oral argument in British Auto Parts, Inc. v. National Labor Relations Board, No. 21,883, for the same day before the same panel. Since many of the issues raised by appellant herein have been fully discussed in our brief heretofore filed in No. 21,883, that brief is incorporated by reference and will be duly served upon counsel for appellant herein. The instant brief deals only with those issues raised by Teledyne not already fully considered and discussed in the Board's brief in No. 21,883.

II. THE EXCELSIOR RULE IS A VALID EXERCISE OF THE BOARD'S POWER TO REGULATE REPRESENTATION ELECTIONS

The reasons for the promulgation of the Excelsior rule have been fully set forth by the Board in the Excelsior decision itself

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(Excelsior Underwear, Inc., 156 NLRB 1236), and are summarised in our brief in British Auto Parts.[3/] Here, as in British Auto Parts, the Company attacks the rule on the ground that it is a per se rule and therefore contrary to the decisions of the Supreme Court in N.L.R.B. v. United Steelworkers, 357 U.S. 357, and in N.L.R.B. v. Babcock & Wilcox Co., 351 U.S. 105. We pointed out at p. 18 in our British Auto brief, however, that in those cases, the Court was dealing with the circumstances under which the Board might find an employer to have committed an unfair labor practice in violation of Section 8 of the Act; they clearly have no application as a limitation on the Board's power to adopt uniform election rules establishing the procedures for the expression of a free employee choice in representation elections. For, it is well settled that the Board may, by rule of decision, establish general rules for the conduct of representation proceedings. See, e.g., N.L.R.B. v. A. J. Tower, 329 U.S. 324 (rule that eligibility of voter may not be challenged after ballot has been cast); N.L.R.B. v. Hood Corp., 346 F. 2d 1020,

3/ In our British Auto Parts brief, we cited two appellate court decisions sustaining the Excelsior rule and enforcing the Board's subpenas: N.L.R.B. v. Hanes Hosiery, 384 F. 2d 188 (C.A. 4); and N.L.R.B. v. Rohlen, 385 F. 2d 52 (C.A. 7). The employer's petition for certiorari in Hanes has since been denied. See 88 S. Ct. 1041. No petition for certiorari was filed in Rohlen.

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1021-1022 (C.A. 9) (rule that pre-election agreements between the parties settling questions of voter eligibility must be in writing to be binding); Foreman & Clark, Inc. v. N.L.R.B., 215 F. 2d 396, 400-401, 409-410 (C.A. 9), cert. denied, 348 U.S. 887 (rule that non-coercive pre-election speech by employer on his property, timed so as to deny union an adequate opportunity to reply under similar circumstances, is prejudicial to fair election and warrants setting election aside); N.L.R.B. v. Ideal Laundry & Dry Cleaning Co., 330 F. 2d 712, 718-719 (C.A. 10) (rule that signed ballots are void); Rockwell Mfg. Co. v. N.L.R.B., 330 F. 2d 795, 798 (C.A. 7), cert. denied, 379 U.S. 890 (rule that in elections conducted by consent of the parties, no objections will be entertained relating to electioneering conduct occurring prior to the execution of the consent election agreement); National Van Lines, Inc. v. N.L.R.B., 273 F. 2d 402, 403, 407 (C.A. 7) (rule that mail ballots received after deadline set forth in election notice will not be counted); N.L.R.B. v. Shirlington Supermarket, Inc., 224 F. 2d 649, 651-653 (C.A. 4), cert. denied, 350 U.S. 914 (similar to Foreman & Clark, supra). See also Ray Brooks v. N.L.R.B., 348 U.S. 96, 98 (rule that, absent unusual circumstances, an employer must honor a union's certification for one year even though union might have lost its majority support); N.L.R.B. v. Trimfit of California, 211 F. 2d 206, 209, n. 2 (C.A. 9) (rule that representation elections will not be conducted during the pendency of unwaived unfair labor practice charges); Milk and Ice Cream Drivers v. McCulloch, 306 F. 2d 763, 766 (C.A.D.C.) (rule that a valid collective bargaining agreement will bar an election for only the first two years

of its life); International Association of Tool Craftsmen v. Leedom, 276 F. 2d 514 (C.A.D.C.), cert. denied, 364 U.S. 815 (rule that petitions for severance elections must be coextensive with the existing bargaining unit from which a union seeks to detach specified categories of employees).

The Company's suggestion that the Board may not establish an election rule of uniform application, but must delay the election in each case for an evidentiary hearing on the necessity or desirability of applying the rule to those facts, is plainly without merit. The cases cited above show that the law is to the contrary. See, in particular, Milk and Ice Cream Drivers v. McCulloch, supra, 306 F. 2d at 766, where the court, commenting on the contention that the Board must hold an evidentiary hearing every time it applied its two-year contract bar rule to contracts of longer duration, stated, "It seems to us that this amounts to saying that due process of law does not permit the Board to establish a general rule on the subject, and this, as we have indicated, would be inconsistent with a fundamental policy of the Act . . . ." Here, the fundamental policy is that questions of representation be resolved by an informed electorate speedily, with a minimum of procedural and administrative steps which might serve to delay the election and render uncertain the finality of the results.

Teledyne also attacks Excelsior on the ground that many of its employees are highly skilled, and that their names and addresses "are valuable trade secrets" to be protected from possible disclosure

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by a union to competiors. A similar argument was made in N.L.R.B. v. Rohlen, 385 F. 2d 52 (C.A. 7). In rejecting it, the Seventh Circuit said (id., at 55, n. 2):

> These objections are without substance. Nothing in the record supports the argument that disclosing the names and addresses of employees will in the future or has in the past resulted in piracy. A union that is bent on engaging in such unconscionable practices will surely not be deterred by the unavailability of an Excelsior list. And as the Board stated in a different context, equally relevant to employee piracy, "We cannot assume that a union, ... will engage in conduct of this nature; if it does, we shall provide an appropriate remedy.

That answer is equally applicable here. In any event, the Company's claimed necessity for secrecy is belied by the encouragement it gave its employees to provide their names and addresses on a voluntary basis to the Board for transmission to the Union.

Equally insubstantial is appellant's claim that the Excelsior rule invades a constitutionally protected "zone of privacy" of its employees. In the first place, the Company does not have standing to raise this defense because it belongs to persons who are not parties to this proceeding. Unlike N.A.A.C.P. v. Alabama, 357 U.S. 449, and the other cases cited at pp. 26-27 of the Company's brief, there is no identity of interest here between Teledyne and its employees, nor will Teledyne suffer any injury by producing the

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required list. See pp. 12-14 of our brief in British Auto Parts. Assuming for the moment that the employees have a broad constitutional right "to be free from unwanted or bothersome intrusions", as their employer claims (Co. Br. p. 25), they can protect it simply by closing the door on the visitor or hanging up on the caller when they determine that he is unwanted or bothersome.

Secondly, Excelsior is not unconstitutional. If the sale by a state of the names and addresses of motor vehicle registrants to the highest bidder for commercial purposes does not violate any constitutional right of the registrants (see Lamont v. Commissioner of Motor Vehicles, 269 F. Supp. 880 (S.D. N.Y.)), then, a fortiori, giving the parties to an election the voters' names and addresses does not violate the voters' constitutional right of privacy. As stated by Judge Frankel in Lamont, supra, at 883:

> The mail box, however noxious its advertising contents often seem to judges as well as other people, is hardly the kind of enclave that requires constitutional defense to protect "the privacies of life." The short, though regular, journey from mail box to trash can -- for the contents of which the State chooses to pay the freight when it facilitates the distribution of trash -- is an acceptable burden, at least so far as the Constitution is concerned. And the bells at the door and on the telephone, though their ring is a more imperious nuisance than the

mailman's tidings, accomplish more peripheral assaults than the blare of an inescapable radio /see Public Utilities Commission v. Pollak, 343 U.S. 451/.[4]

III. THE BOARD'S ADOPTION OF THE EXCELSIOR RULE DID NOT CONTRAVENE THE REQUIREMENTS OF THE ADMINISTRATIVE PROCEDURE ACT

Finally, the Company seeks to have the Court void the Excelsior requirement on the ground that the Board did not comply with the rule-making provisions of the Administrative Procedure Act (5 U.S.C. Sections 552, 553 (1967)). The district court's rejection of this argument is fully supported by the relevant case law.

It is well settled that the Board has authority both to promulgate rules legislatively under Section 6 of the National Labor

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4/ Teledyne's suggestion that Public Utilities Commission v. Pollak, supra, was impliedly overruled by Griswold v. Connecticut, 381 U.S. 479, because Justice Douglas, who dissented in Pollak, wrote the majority opinion in Griswold, need not give this Court much pause. Griswold deals only with governmental interference in the most personal relationships between husband and wife; nothing in the opinion of the Court purports to lay down the broad rule Teledyne is promoting that governmental action is unconstitutional simply because it might result in an unwanted letter, telephone call or knock on the door at a person's home.

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Relations Act and to proceed by rule of decision, on a case-by-case basis, under Section 9 and 10 (29 U.S.C. Secs. 156, 159, 160). See S.E.C. v. Chenery Corp., 332 U.S. 194, 201-203; N.L.R.B. v. Seven-Up Bottling Co., 344 U.S. 344, 347-349; Foreman & Clark, Inc. v. N.L.R.B., supra, 215 F. 2d at 409-410; N.L.R.B. v. Pittsburgh Plate Glass Co., 270 F. 2d 167, 174 (C.A. 4), cert. denied, 361 U.S. 943; N.L.R.B. v. A.P.W. Products Co., 316 F. 2d 899, 905 (C.A. 2); N.L.R.B. v. Penn Cork & Closures, Inc., 376 F. 2d 52, 57 (C.A. 2); N.L.R.B. v. E & B Brewing Co., Inc., 276 F. 2d 594, 598 (C.A. 6), cert. denied, 366 U.S. 908; Optical Workers Union v. N.L.R.B., 227 F. 2d 687, 690-691 (C.A. 5), cert. denied, 351 U.S. 963.[5/] When the Board elects to proceed by rule of decision, as it did in Excelsior, the publication and rule-making provisions of the APA have no application. See N.L.R.B. v. A.P.W. Products Co., supra, 316 F. 2d at 905; N.L.R.B. v. Penn Cork & Closures, Inc., supra, 376 F. 2d at 57;

5/ In exercising its authority under Section 9(c) of the Act, the Board has "evolved a number of working rules" through the decisional process. Ray Brooks v. N.L.R.B., 348 U.S. 96, 98. As shown by the cases cited ante, pp. 5-7 , many of the Board's decisional rules are, like Excelsior, directed to establishing the conditions for a fair and free expression of employee choice in representation elections. One of the best known is the rule announced by the Board in its decision in Peerless Plywood, 107 NLRB 427, that no campaign speeches shall be made in the last 24 hours before a Board-directed election. See N.L.R.B. v. Dallas City Packing Co., 251 F. 2d 664, 666 (C.A. 5).

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N.L.R.B. v. E & B Brewing Co., Inc., supra, 276 F. 2d at 598. The Board thus acted wholly within the scope of its discretion by promulgating the Excelsior rule in an adjudicative proceeding and by applying it to the instant case.

Appellant relies heavily on Hotch v. United States, 212 F. 2d 284 (C.A. 9), for the proposition that the Board's failure to publish the Excelsior rule in the Federal Register makes it invalid. That case, however, is distinguishable on several counts. The strict requirement of publication could be justified there because it was a criminal case, whereas this case is not. Portage Broadcasting Corp. v. FCC, 326 F. 2d 674, 690 (C.A.D.C.). Furthermore, it cannot be said that the Company here has been prejudiced in any way by the failure to publish. Reich v. Webb, 336 F. 2d 153, 159 & n. 7 (C.A. 9); FCC v. Schreiber, 329 F. 2d 517, 528, modified and remanded on another ground, 381 U.S. 279. The Company knew, at least from the time of the issuance of the direction of election, that the Board required production of an appropriate list of names and addresses. See R. 8, n. 2. The record shows that the Company has had many opportunities to challenge the rule and to argue why it should not apply in this case, and has taken advantage of them. The Board has heard and rejected these arguments.

In addition, the Company's claim (Br. p. 30) that it is not bound by the rule in Excelsior since it was not given an opportunity to be heard in that case is equally lacking in merit. Before promulgating the rule, the Board invited and accepted amicus curiae

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briefs from "interested parties" (156 NLRB at 1238) -- included in this group were the Chamber of Commerce of the United States and the National Association of Manufacturers, both of which represent the interests of management. Even now, the Company does not suggest that it has any objections to the Excelsior rule which were not advanced by others in that case. Judge Leventhal's comments in City of Chicago v. FPC, 385 F. 2d 629, 643 (C.A.D.C.), are particularly appropriate here:

> On this record /the Company/ shows no substantial ground for a difference in result because the agency declared a general principle in the context of an individual proceeding, but with leave to the industry to participate amicus curiae; it was free to utilize this technique notwithstanding the efforts of courts and scholars to encourage greater use of regulations for broad policy declaration.

The choice between adjudication and rule making is "a question of judgment, not of power" N.L.R.B. v. A.P.W. Products Co., 316 F. 2d at 905; and where, as here, the Company has been given notice and an opportunity to defend, the agency's choice should not be disturbed.

IV. THE DISTRICT COURT PROPERLY ENFORCED THE BOARD'S SUBPENA

Relying primarily on the district court decision in N.L.R.B. v. Q-T Shoe Co., 67 LRRM 2356 (D. N.J.), appeal pending (C.A. 3, Docket No. 17,203), the Company asserts that the Excelsior list sought in this case is not evidence within the meaning of Section 11 of the Act because it will not be used by the Board to prove or disprove anything in dispute before the Board, but will merely be turned over to the Union for the latter's use during the pre-election campaign. Accordingly, appellant's argument goes, the Board cannot use its subpena powers to procure the employees' names and addresses.

A similar argument was made in British Auto Parts, and is answered at pp. 28-32 of the Board's brief therein. The Board's response can best be summarized in the following quotation from N.L.R.B. v. Rohlen, supra, 385 F. 2d at 57:

> Section 11(2) itself reveals the erroneous nature of the company's contention. The crucial words in that section are "to produce evidence . . . or . . . give testimony touching the matter under investigation or in question." From this language, it is clear that a party can be requested, by virtue of a subpoena, "to produce evidence" concerning a "matter under investigation." When this rather obvious observation is coupled with the commonly accepted function of an investigation, the gathering of facts and information, the company's position becomes untenable. The company would read the words just quoted without the phrase "under investigation." A more appropriate reading

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would place primary emphasis on those words. Thus, if the material subpoenaed touches a matter under investigation, it is within the scope of section 11(2) even though the material may not be considered "evidence" as the term is employed in the courtroom.

Moreover, the list of employee names and addresses is evidence relating to a "matter . . . in question." Even if we adopt the orthodox view that evidence tends to prove or disprove the existence of a disputed fact or something in issue, the "something in issue" in a representation proceeding under section 9 is the employee group-preference. An Excelsior list, by faciliating a fully informed electorate, is evidence which aids in the establishment of that group-preference.

The district court in Q-T Shoe ignored Rohlen, as well as N.L.R.B. v. Hanes Hosiery, supra, although both cases were called to its attention. Teledyne attacks Rohlen on the ground that the Seventh Circuit erred in stating that the basic issue in a representation proceeding -- i.e., the matter under investigation -- is the employee group-preference (Co. Br. p. 13). It is settled, however, that the entire representation proceeding, from the preliminary determination of "probable cause to believe that a question of representation affecting commerce exists" through certification of the results of the election, is an "investigation" within the meaning of Sections 9(c) and 11 of the Act. See, e.g., Inland Empire District Council v. Millis, 325 U.S. 697, 706; N.L.R.B. v. Duval Jewelry Co., 243 F. 2d 427, 431 (C.A. 5), aff'd on this point, 357 U.S. 1; Kearney & Trecker Corp. v. N.L.R.B., 209 F. 2d 782, 786 (C.A. 7). Accordingly, it is the

Company that errs when it claims that there is nothing at issue before the Board to which the list is pertinent.[6/] As indicated above, the ultimate question to be resolved in this representation proceeding is what choice the employees will express under free and fair election procedures. Until that question has been resolved, the Board representation investigation under Section 9(c) is not complete and the predicate for issuance and enforcement of Board subpenas under Section 11 is not exhausted. See Cudahy Packing Co. v. N.L.R.B., 117 F. 2d 692, 693 (C.A. 10).

The Company also claims that if the Board can subpena the names and addresses of employees in order to aid them to make a more intelligent choice in the election, it can subpena any information in the Company's possession which the Board might deem helpful to a union in its organizing campaign, such as the employer's cost and profit figures. This argument misconceives the nature of the Board's role in representation proceedings. The Board's function is to regulate the election process so that the employees will be in a position to vote intelligently, not to aid the parties to formulate their campaign material. The Excelsior rule was adopted to open up avenues of communication between the parties and the electorate on the assumption that employees will thereby be better able to make a more fully

6/ The Company asserts (Br. 13) that there is no need for the Excelsior list because the election has been held and there were no objections to conduct and no challenged ballots sufficient to affect the results of the election. This argument ignores the fact that the first election was set aside and a second election directed for which there will be a new eligibility list and a new pre-election campaign.

informed and reasoned choice. The Board only gets involved in the substance of a pre-election campaign if it is alleged that there has been conduct which made such a choice impossible.

V. THE COMPANY HAS NOT SUBSTANTIALLY COMPLIED WITH EXCELSIOR

The Company's final argument (Br. 31) is that it has substantially complied with Excelsior, and that enforcement of the subpena should therefore be denied. To support this assertion, the Company apparently relies on three factors: (1) that it had a policy of permitting employees to campaign for and against union representation on company time and property so long as the campaigning did not interfere with their work; (2) that it provided employees with stamped, addressed envelopes with which they could mail their names and addresses to the Board; and (3) that it offered to provide an independent third party to mail the Union's literature to its employees.

In adopting the Excelsior rule, however, the Board considered all of these alternatives and rejected them as not providing an adequate substitute for making known to the union directly the names and addresses of all the eligible employees. The Board said (Excelsior Underwear, Inc., 156 NLRB 1236, 1241):

> This is not, of course, to deny the existence of various means by which a party might be able to communicate with a substantial portion of the electorate even without possessing their names and addresses. It is rather to say what seems to us obvious -- that the access of all employees to such communications can be insured only if all parties have the names and addresses of all the voters.

Inc.

/In a footnote to the foregoing, the Board added:/

> A union that does not know the names and addresses of some of the voters may seek to communicate with them by distributing literature on sidewalks or street corners adjoining the employer's premises or by utilizing the mass media of communication. The likelihood that all employees will be reached by these methods is, however, problematical at best. * * * Personal solicitation on plant premises by employee supporters of the union, while vastly more satisfactory than the above methods, suffers from the limited periods of nonworking time available for solicitation . . . and, in a large plant, the sheer physical problems involved in communicating with fellow employees.

With regard to the Company's offer to provide the list to a mailing service which would send out the Union's literature, the Board said in Excelsior (id., at 1246):

> We do not limit the requirement of disclosure to furnishing employee names and addresses to a mailing service . . . because this would create difficult practical problems and because we do not believe that the union should be limited to the use of the mails in its efforts to communicate with the entire electorate.

In sum, while the Board does not apply the Excelsior rule mechanically in that erroneous listings or late filing will not automatically be construed as noncompliance with the rule, the Board

has not accepted as a substitute for compliance those very devices which it found to be inadequate in the first place.

VI. THE DECISION OF THE DISTRICT COURT SHOULD BE AFFIRMED ON THE ALTERNATIVE GROUND ADVANCED BY THE BOARD

Count II of the Board's complaint in the district court requested the issuance of a mandatory injunction directly enforcing the Excelsior rule, to aid the Board in pursuing its statutory functions (R. 4). The district court, upon granting enforcement of the subpena duces tecum under Count I, declined to rule on Count II. Nevertheless, this Court could affirm the district court on this alternative ground. M.O.S. Corp. v. John I. Haas Co., 375 F. 2d 614, 617 (C.A. 9), and cases cited; S & S Logging Co. v. Barker, 366 F. 2d 617, 623 (C.A. 9). For the reasons already discussed in our British Auto Parts brief (pp. 29-35), we submit that the judgment of the district court may be affirmed on this alternative ground.

CONCLUSION

For the reasons stated herein and in the Board's brief in British Auto Parts v. N.L.R.B., No. 21,883, we respectfully submit that the District Court properly ordered the Company to file with the

Regional Director the names and addresses of the employees in the unit, in compliance with the Excelsior rule and the Board's subpena.

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May 1968.

CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST,
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National Labor Relations Board.

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No. 22,354

IN THE

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FOR THE NINTH CIRCUIT

TELEDYNE, INC.

Appellant,

v.

NATIONAL LABOR RELATIONS BOARD,

Appellee.

Appeal from the United States District Court of the Northern District of California

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APPELLANT'S REPLY BRIEF

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No. 22,354

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APPELLANT'S REPLY BRIEF

ARGUMENT*

I. THE *EXCELSIOR* RULE IS INVALID BECAUSE IT WAS PROMULGATED WITHOUT COMPLIANCE WITH THE ADMINISTRATIVE PROCEDURE ACT.

The Board failed to comply with the Administrative Procedure Act, 5 U.S.C. § 1001, *et seq* (1964),** herein-

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* Words defined in Appellant's Opening Brief, will be used herein in the same manner as in said Opening Brief.

** The *Excelsior* Rule was announced by the Board on February 4, 1966. The APA then in force was the Act of June 11, 1946, ch. 324, 60 Stat. 238 (codified at 5 U.S.C. § 1001, *et seq* (1964)). It was superseded by the Act of September 6, 1966, 80 Stat. 383, (5 U.S.C.A. § 551, *et seq* (1967)), which made changes which do not affect the issues in this case. The citations in the text are to the APA in force when *Excelsior* was promulgated.

after called the "APA", when it promulgated *Excelsior,* and for this reason the rule cannot be enforced. *Wyman-Gordon Co. v. NLRB,* No. 7000 (1st Cir., June 12, 1968), 119 BNA Daily Labor Rep. at A-1 (June 18, 1968).

In *Wyman-Gordon, supra,* the United States Court of Appeals for the First Circuit held that in *Excelsior,* the Board was promulgating a "rule" within the meaning of the APA, and that the publication requirements of said Act applied. The Court stated:

> "Recognizing the problem to be one affecting more than just the parties before it, the Board chose to solicit the assistance of selected amici curiae, and, ultimately, to establish a rule which not only did not apply to the parties before it, but did not take effect for thirty days. In so doing we consider that the Board, to put it bluntly, designed its own rulemaking procedure, adopting such part of the Congressional mandate as it chose, and rejecting the rest. . .
>
> "In *Excelsior* . . . the Board did not decide a case between party and party, or, more exactly, it decided a case one way, and took occasion to lay down a future rule the other way. *Chenery* in no fashion suggests approval of this. On the contrary, to the extent the Board was not deciding a case, this is precisely where Congress had instructed it as to the procedure it should adopt. The Board has chosen to disregard Congress." (Footnote omitted.)

The Court further held that because of the failure to follow the APA a subpoena similar to the instant subpoena could not be enforced, and dismissed the Board's complaint. The Court stated that to do otherwise would permit the Board, or any other agency, to emasculate the APA.

Wyman-Gordon, supra, makes it clear that the arguments of the Board regarding its requirement to comply with the APA are fallacious. The cases the Board cites* hold only that once an agency decides to proceed by adjudication rather than rule-making, the publication procedures of the APA do not apply. While the Board, at its discretion, may proceed either on a case-by-case method or by establishing general rules, no case it cites permits the APA to be ignored when the Board promulgates a prospective general rule, like the *Excelsior* rule, which does not apply to the parties before it. As *Wyman-Gordon, supra,* indicated, to permit the Board to characterize what it was doing in *Excelsior* as an adjudication is to make a mockery of the distinction between the two kinds of procedures.

Kessler v. F.C.C., 326 F.2d 673 (D.C. Cir. 1963) (Cited by the Board as *Portage Broadcasting Corp. v. F.C.C.*) involved the publication of a procedural rule under Section 3(a), not Section 4, of the APA. Procedural rules are specifically exempted from Section 4, which requires publication of the proposed rule making in the Federal Register, and requires that an opportunity to participate in the rule making be afforded to all interested parties. The Court in *Kessler, supra,* held that, since the complaining parties had actual notice of the proper procedures, the lack of publication was not prejudicial. Failure of an Agency to comply with the APA with

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* *N.L.R.B. v. Seven-Up Bottling Company,* 344 U.S. 344 (1953); *SEC v. Chenery Corporation,* 332 U.S. 194 (1947); *NLRB v. Penn Cork & Closures, Inc.,* 376 F.2d 52 (2d Cir. 1967); *NLRB v. A.P.W. Products Co.,* 316 F.2d 899 (2d Cir. 1963); *NLRB v. E & B Brewing Co.,* 276 F.2d 594, (6th Cir. 1960); *Optical Workers Union v. NLRB,* 227 F.2d 687 (5th Cir. 1955); *Foreman & Clark, Inc. v. NLRB,* 215 F.2d 396 (9th Cir. 1954).

respect to the promulgation of rules of substance has a more serious effect than failure regarding procedural rules. Actual knowledge of a new rule, after it has been adopted, does not cure the defect, since it is not unawareness of the rule which is complained of, but rather that the manner in which the rule was adopted makes it invalid. The intent of Congress would be completely frustrated if agencies could circumvent the APA with regard to rules of substance, like the *Excelsior* rule.

The *Excelsior* rule is clearly not a rule of procedure. The Court in *Wyman-Gordon, supra,* stated:

> ". . . We can only conclude that *Excelsior's* purpose is what it appears to be on its face, a provision requiring the employer to furnish interested parties with affirmative assistance in conducting their election campaigns.
>
> "Such assistance is substance, not Board procedure. It differs only in degree and not in kind from a requirement, for example, that an employer having an assembly hall or a printing press should make it available to groups requesting it. . . ."

Similarly, *Reich v. Webb,* 336, F.2d 153 (9th Cir. 1964), involved notice under Section 3, not the hearing of all points of view under Section 4. Furthermore, the Court held that the rule involved was a common law rule, and therefore, not within the scope of the APA. *F.C.C. v. Schreiber,* 29 F.2d 517 (9th Cir. 1964) also involved a procedural rule. *City of Chicago v. F.P.C.,* 385 F.2d 629, (D.C. Cir. 1967) was a proceeding by adjudication and did not involve an invalid attempt at rulemaking. The Court simply held that petitioners were not prejudiced by the fact that the Commission proceeded by adjudication and not by rule-making.

On the basis of the foregoing, it is clear that the *Excelsior* rule was promulgated in a manner in direct violation of the APA and therefore cannot be enforced.

II. THE SUBPOENA IS UNENFORCEABLE BECAUSE THE *EXCELSIOR* RULE IS NOT VALID.

A. The *Excelsior* Rule Is Invalid Because It Is A *Per Se* Rule In Direct Violation Of United States Supreme Court Decisions.

NLRB v. A. J. Tower, 329 U.S. 324 (1946), and the other cases like it cited by the Board (Bd. Br. pp. 5-7), are cases where Board election rules have been upheld by courts. However, they do not hold that the Board has a *carte blanche* in this area. In addition, none of the cases concerned the Board acting in a manner contrary to clear Supreme Court prohibitions similar to *Nutone* and *Babcock.* The fact that the courts have upheld certain rules as valid exercises of the Board's power to regulate elections in no way supports the contention that every election rule must be upheld. See *NLRB v. Virginia Electric & Power Company,* 314 U.S. 469 (1941); *NLRB v. Ford Motor Company,* 114 F.2d 905 (6th Cir. 1940).

B. The *Excelsior* Rule, As Applied In The Instant Case, Is Invalid Because It Violates The Constitutionally Protected Right Of Privacy.

The Supreme Court has recently decided a case that confirms the appellant's standing to assert that *Excelsior* is invalid because it invades a constitutionally protected zone of privacy. In *Flast v. Cohen,* 36 U.S.L.W. 4601 (U.S. June 10, 1968), the Supreme Court held that a federal taxpayer has standing to challenge allegedly unconstitutional federal spending programs. The Court described the basis for standing as follows:

> ". . . The fundamental aspect of standing is that it focuses on the party seeking to get his complaint before a federal court and not on the issues he wishes to have adjudicated. The 'gist of the question of standing' is whether the party seeking relief has 'alleged such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions . . .'"

If a mere taxpayer has a "personal stake" in a federal spending program, *a fortiori,* the appellant has a sufficient "personal stake" in the instant case to support its standing. It is clear that the appellant has a sufficient stake to assure that the Court will receive a full presentation of the issue in question.

Lamont v. Commissioner of Motor Vehicles, 269 F. Supp. 880, (S.D.N.Y.) *aff'd per curium,* 386 F.2d 449 (2d Cir. 1967), cited by the Board, involved the sale of the names and addresses of motor vehicle registrants, which were already a matter of public record. As the Court stated:

> "The information sold by the Commissioner is not vital or intimate. It is, moreover, in the category of 'public records', available to anyone upon demand. See Vehicle and Traffic Law § 401(2). Indeed, questions more troublesome than plaintiff's might arise if the State adopted a policy of 'privacy' or 'secrecy' with respect to such information. What the State has done in practical effect is to tap a small source of much-needed revenue by offering a convenient 'packaging' service." 269 F. Supp. at 883

The probability of home visitation was slight in that situation, while there is a great probability of such visits

in the instant situation. *Wheeler v. Sorensen Mfg. Co.*, 415 S.W.2d 582, 65 LRRM 2408 (Ky. 1967) was a tort action against an employer alleging it violated an employees right of privacy by showing a copy of her pay check to other employees. There is no indication that her address was given out. The constitutional issue presented in the instant case was not considered in *Wheeler*.

Martin v. City of Struthers, 319 U.S. 141 (1943), and *Staub v. City of Baxley,* 355 U.S. 313 (1958), involved local ordinances which the Court felt imposed blanket restrictions on the freedom of speech in the community. Certainly, in the instant situation, the union cannot claim that its freedom of speech is abridged because it is not given employee lists.

Addyston Pipe Steel Co. v. U.S. 175 U.S. 221 (1899) held that the "freedom of contract" provision of the United States Constitution does not pre-empt the federal government from enacting legislation under its commerce powers to declare certain contracts void. Similarly, *J. I. Case Co. v. NLRB,* 321 U.S. 332 (1944), held that the fact that an employer had employment contracts with a majority of his employees did not preclude the employees from exercising their right under the National Labor Relations Act to choose a representative for collective bargaining or warrant refusal by the employer to bargain. None of these cases can be used as authority for the proposition that a constitutionally protected right must give way to an administrative ruling.

On the basis of the foregoing, it is clear that the cases cited by the Board are not on point and that the *Excelsior* rule is invalid because it infringes upon a constitutionally protected right of privacy.

III. IRRESPECTIVE OF WHETHER THE *EXCELSIOR* RULE IS VALID, THE SUBPOENA IS UNENFORCEABLE UNDER SECTION 11 OF THE ACT BECAUSE IT DOES NOT CALL FOR THE PRODUCTION OF EVIDENCE TO BE USED BY THE BOARD.

The efforts by the Board to subpoena *Excelsior* lists, under Section 11 are the first attempts by the Board to subpoena matter which will not be used by the Board, and is not probative, or possibly probative, to any issue before it. The cases cited by the Board demonstrate the weakness of the argument that it has the power to do this.

In *Cudahy Packing Co. v. NLRB,* 117 F.2d 692 (10th Cir. 1941), the Court enforced a subpoena for the employer's payroll records. The records contained the names of employees which were needed by the Board to decide the issue of voting eligibility. As the Court stated: "It [the Company] does not, nor could it, contend that the evidence sought by the Board does not relate to the subject under investigation." 117 F.2d at 693. In *NLRB v. Northern Trust Co.,* 56 F.Supp. 335 (N.D. Ill. 1944), *aff'd.,* 148 F.2d 24 (7th Cir. 1945), the Board sought to subpoena certain books and records to determine (a) whether the employer's operations affected interstate commerce, (b) the appropriate bargaining unit, and, (c), the sufficiency of the union's interest showing. The appellant has furnished the Board sufficient information to determine voting eligibility, the sufficiency of the interest showing, and the appropriate bargaining unit.

In *NLRB v. C.C.C. Associates, Inc.,* 306 F.2d 534 (2d Cir. 1962), the Board subpoenaed data to determine whether a corporation was a successor to another corporation's back pay liability. *NLRB v. United Aircraft*

Corporation, 200 F.Supp. 48 (D. Conn. 1961), *aff'd. per curiam* 300 F.2d 442 (2d Cir. 1962), involved a subpoena for employment records which might indicate whether the employer unlawfully discriminated against strikers.

Endicott Johnson Corp. v. Perkins, 317 U.S. 501(1943) involved a subpoena for relevant information to be used to determine whether there was a violation of the Walsh-Healy Public Contracts Act. *Hamilton v. NLRB,* 177 F.2d 676 (9th Cir. 1949) held that whether there was indeed a violation in the matter under investigation is not to be determined in a subpoena enforcement proceeding, where the subpoenaed material was relevant to said investigation, and was to be used by the agency. *U.S. v. Powell,* 379 U.S. 48 (1964), *U.S. v. Feaster,* 376 F.2d 147 (5th Cir. 1967), *NLRB v. Gunaca,* 135 F.Supp. 790 (E.D. Wis. 1955) and *Adams v. F.T.C.,* 296 F.2d 861 (8th Cir. 1961) involved subpoenas of relevant information to be used by the agencies themselves.

NLRB v. Menaged, 193 F.Supp. 135 (D.Md. 1961) and *NLRB v. New England Transportation Co.,* 14 F.Supp. 497 (D. Conn. 1936) involved the subpoenas of items intended for use by the Board. *NLRB v. Groendyke Transport, Inc.,* 372 F.2d 137 (10th Cir. 1967) involved the conduct of a mail ballot, and had nothing to do with enforcing Board subpoenas. (The election in the instant case was not conducted by mail ballot.)

In these, and all the cases cited by the Board, it is obvious that the Board sought information which was probative of issues which the Board was required to decide. The information was used by the Board for this purpose. Clearly, in all these circumstances, the information sought was "evidence." These cases, therefore, do not support the Board's contention that data

which will not be used by the Board, and is not probative of any issue before the Board is also "evidence" within the meaning of the Section 11.

The Board cites *NLRB v. Friedman,* 352 F.2d 545 (3d Cir. 1965) to support its contention that subpoenaed information can be turned over to the union. In that case the Board sought certain records of the employer in order to prove that the employer had discriminatorily transferred some of its operations. The employer defended on the grounds that the Board intended to use a a union accountant and economist to aid it in analyzing these records. The Court found, however, that the garment industry was exceedingly complex and that the Board itself had no experts capable of analyzing the records. Furthermore, the only experts in the entire country were employed by either the employer, its competitors or the union. Under these unusual circumstances, the Court enforced the subpoena and allowed the use of a union expert by the Board.

The *Friedman* case is obviously distinguishable. The subpoenaed material was probative of an issue to be decided by the Board and was thus clearly "evidence," the information was to be used by the Board. The narrowness of the Court's holding in *Friedman* is further demonstrated by the scope of its order. The union accountant and economist was forbidden to reveal the information to anyone except to counsel for the preparation of the unfair labor practice case. The names and addresses of all customers and suppliers were also deleted before the records were shown to the union expert. The Court added that any deviation from these limitations would be subject to contempt. The *Friedman* case therefore stands for the proposition that such subpoenaed information may not be turned over to the union for its own use, but rather may be given to a union for

the purpose of analysis, subject to an appropriate protective order, to aid the Board, where such aid is absolutely necessary.

The Board in its brief also discusses *FTC v. American Tobacco Co.*, 264 U.S. 298 (1924), and *United States v. Morton Salt Co.*, 338 U.S. 632 (1950). The former case involved a petition for writs of mandamus brought by the Attorney General to compel inspection of the records of two tobacco companies. The Supreme Court affirmed the district court's refusal to issue the writs. The Court found that in its search for evidence, the Federal Trade Commission had cast its net too broadly. In essence, the Court required the agency to demonstrate some grounds for supposing that each item sought was *actually* probative. This rule appears to have been subsequently relaxed. In *United States v. Morton Salt Co., supra,* the Court upheld orders by the Federal Trade Commission requiring that certain salt companies submit special reports with respect to compliance with a Court's decree. The Court appears to have indicated in its opinion that information may be required so long as there is a *possibility* that the information sought may be probative of a violation. This relaxation, however, in no way affects the disposition of the instant case. In our case, it is obvious that the *Excelsior* list sought will not be used by the Board and is not probative of any issue to be decided by the Board.

It is therefore submitted that the cases cited by the Board are not relevant, and the subpoena is not enforceable under Section 11.

IV. THE SUBPOENA IS UNENFORCEABLE UNDER 28 U.S.C. § 1337 BECAUSE SECTION 11 OF THE ACT IS A SPECIFIC STATUTE, DEALING WITH THE SUBJECT MATTER, WHICH PREVAILS OVER THE GENERAL PROVISIONS OF 28 U.S.C. § 1337.

The Board is claiming that the Court has jurisdiction to enforce the *Excelsior* rule under 28 U.S.C. § 1337, which gives the Court jurisdiction over "all suits and proceedings under any law regulating commerce." In so doing, the Board is seeking to circumvent the clear legislative effort to limit the scope of its subpoena powers, and is attempting to convince the Court to allow what Congress specifically avoided doing under Section 11, *i. e.,* authorize a "roving commission."

Since the subpoena is invalid under Section 11 (see Appellant Opening Brief pages 6-14), which specifically governs the Court's power to enforce Board subpoenas related to hearings or investigation under Section 9 of the Act, it cannot be saved by the broad scope of 28 U.S.C. § 1337. The courts have adopted a firm rule of construction designed to foreclose the situation where a result which is precluded by a specific statute is permitted under a general statute. To rule otherwise would render the specific statute nugatory and frustrate the legislative policy behind such statute. If the Court were to enforce the instant subpoena under 28 U.S.C. § 1337, it would have this undesired result.

The rule of construction described above was best stated, and clearly applied, by the Supreme Court in *D. Ginsberg & Sons, Inc. v. Popkin,* 285 U.S. 204 (1932). That case dealt with the jurisdiction of courts to order arrests under the Federal Bankruptcy Act. Section 2 of the Bankruptcy Act gave bankruptcy courts jurisdiction

to "make such orders, issue such process, and enter such judgment in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this Act." This provision, broadly construed, would give the Court jurisdiction to order the arrest of bankrupt persons or to order the arrest of officers of bankrupt persons. However, Sections 9 (a) and 9 (b) of the Bankruptcy Act dealt specifically with circumstances under which bankrupt persons could be arrested. Sections 9 (a) and 9 (b) did not expressly exclude arrests under other circumstances, so it was argued that an arrest under the broad section was permissible. The Court held that if the Court did not specifically have jurisdiction to order arrests under Sections 9 (a) or 9 (b), jurisdiction could not be obtained under the broader provisions of Section 2. The Court said:

> "General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment. *United States v. Chase,* 135 U.S. 255, 260. Specific terms prevail over the general in the same or another statute which otherwise might be controlling. *Kepner v. United States,* 195 U.S. 100, 125. *In re Hassenbusch,* 108 Fed. 38. *United States v. Peters,* 166 Fed. 613, 615." 285 U.S. at 208.

D. Ginsberg & Sons is very close to the instant case. There, a statute dealt specifically with a subject — jurisdiction to order arrests. It did not provide for jurisdiction to order the arrest sought. An attempt was made to use a general statute to grant jurisdiction to order the arrest not provided for in the specific statute, but the Court stopped the attempt and said the specific statute was the exclusive source of jurisdiction over the subject. Here, a statute also deals specifically with a subject —

the jurisdiction of the Board to enforce subpoenas to produce evidence in hearings or investigations related to Sections 9 and 10 of the Act. As has been shown, it does not provide jurisdiction to enforce the instant subpoena. Here also there is a general statute, which is being used in an attempt to grant jurisdiction to enforce the subpoena. The Court should rule, as in *Ginsberg,* that the specific statute, Section 11, is the exclusive source of jurisdiction to enforce such subpoenas.

The *Ginsberg* rule of construction has been quoted innumerable times by federal and state courts as the cardinal rule of statutory construction where general and specific statutes are in conflict. See, e. g. 2 Sutherland, *Statutory Construction* §§ 4704 n. 1, 5204 n. 4 (Cum. Supp. 1968). Indeed, 28 U.S.C. § 1337 has been held not to be a residuary source of jurisdiction in the labor field.

In *United Electrical Contractors Assoc. v. Ordman,* 258 F.Supp. 758 (S.D.N.Y. 1965), the Court held it did not have the power under Section 10 (f) of the Act to review the refusal of the General Counsel of the Board to issue a complaint. It then held that 28 U.S.C. § 1337 is not an alternative source of jurisdiction where there is a specific statute governing the matter: "It is clear that general statutes do not confer jurisdiction where an applicable regulatory statute precludes it." 258 F. Supp. at 762, 763.

Fourco Glass Co. v. Transmirra Products Corp., 353 U.S. 222 (1957), dealt with venue provisions of the Federal Judicial Code. 28 U.S.C. § 1400 (b) provided venue in patent cases in any district where defendant has committed patent infringements. 28 U.S.C. § 1391 provided venue over corporations generally in any district where a corporation did business. The Court said that the specific statute dealing with patents prevailed:

> "We think it is clear that § 1391 (c) is a general corporation venue statute, whereas § 1400 (b) is a special venue statute applicable, specifically, to *all* defendants in a particular type of actions, *i.e.*, patent infringement actions. In these circumstances, the law is settled that 'However inclusive may be the general language of a statute, it "will not be held to apply to a matter specifically dealt with in another part of the same enactment. . . . Specific terms prevail over the general in the same or another statute which otherwise might be controlling." *Ginsberg & Sons v. Popkin,* 285 U.S. 204, 208.' *MacEvoy Co. v. United States,* 322 U.S. 102, 107." 353 U.S. at 228-29.

Venue in patent cases was held to be determined solely by the section of the Code dealing with patent venue — the general venue sections did not provide alternative sources of venue.

Buffum v. Chase National Bank, 192 F.2d 58 (7th Cir. 1951), is very similar to the *Fourco case.* It also dealt with venue provisions of the Federal Judicial Code. 12 U.S.C. § 94 provided venue in actions against banks in any district where the bank has its place of business. 28 U.S.C. § 139 provided venue in actions against corporations in any district where the corporation was doing business. The question was whether venue was proper in an action against a bank in a district where the bank was doing business but where it did not have its place of business. The Court said again that the specific statute prevailed. The general venue provision did not provide an alternative source of venue to the specific bank venue provision. The Court quoted the familiar rule of construction:

> " 'It is a well-settled principle of construction that specific terms covering the given subject matter will

prevail over general language of the same or another statute which may otherwise prove controlling.' " 192 F.2d at 61.

Boire v. Greyhound Corp., 376 U.S. 473 (1964) held that the conduct of an election under Section 9 of the Act can not be enjoined under 28 U.S.C. § 1337 because of an alleged improper Board determination of an appropriate bargaining unit. The Court ruled that the Board had not acted in excess of its powers, and action under a 28 U.S.C. § 1337 would ignore the specific statutory scheme established by Congress.

The weakness of the Board's argument is apparent from an analysis of its argument that there is no specific statute for enforcement of its election rules and the cases it cites. In no cited case was the applicability of 28 U.S.C. § 1337 weighed against a different statute covering the specific matter in question.* Some cases enforcing the

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* In *Capital Service, Inc. v. NLRB*, 347 U.S. 501 (1954), two issues were involved. First, to determine the applicability of 28 U.S.C. § 1337 the court considered whether cases arising under the Act were cases arising under laws regulating commerce. The court held, of course, that labor cases did arise under laws regulating commerce. The only other issue was whether the wording of 28 U.S.C. § 2283, granting only limited power to federal courts to stay state court proceedings, allowed the court to grant the requested injunction. No conflict in jurisdictional statutes was involved. *Amalgamated Clothing Workers v. Richman Bros.*, 348 U.S. 511 (1955), involved exactly the same issue as *Capital Service, Inc. v. NLRB, supra. NLRB v. New York State Labor Board,* 106 F.Supp. 749 (S.D. N.Y. 1952), did not even involve § 1337 — jurisdiction under that statute was clear. The court merely held that it had authority to issue an injunction even where that power was not expressly granted by statute. *Federal Maritime Commission v. Atlantic & Gulf/Panama Canal Zone*, 241 F.Supp. 766 (S.D. N.Y. 1965), also involved § 1337, but there was no issue

Board's subpoenas for *Excelsior* lists also found jurisdiction under 28 U.S.C. § 1337, *NLRB v. British Auto Parts, Inc.,* 64 L.R.R.M. 2786 (C.D. Cal. 1967); *NLRB v. Wolverine Industries Div.,* 64 L.R.R.M. 2187 (E.D. Mich. 1967); *N.L.R.B. v. Rohlen,* 64 LRRM 2169 (N.D. Ill. 1967), *aff'd on alternate ground,* 385 F.2d 52 (7th Cir. 1967). But these cases merely recited the inapplicable cases relied upon by the Board. *NLRB v. Hanes Hosiery Div.,* 384 F.2d 188 (4th Cir. 1967) did not even

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as to whether it applied to the case. The main issue was whether a court could issue an injunction to aid an administrative agency even though there was no express authorization for such an injunction. *Los Angeles Trust Deed & Mortgage Exchange v. SEC,* 285 F.2d 162 (9th Cir. 1960), did not involve § 1337. It merely held that a court has inherent equity powers to aid in the effectuation of legislative policy. *Reich v. Webb,* 336 F.2d 153 (9th Cir. 1964), and *Walling v. Brooklyn Braid Co.,* 152 F.2d 938 (2d Cir. 1945), involved exactly the same issue as *Los Angeles Trust Deed & Mortgage Exchange, supra. United States v. Feaster,* 330 F.2d 671 (5th Cir. 1964); 376 F.2d 147 (5th Cir. 1967) held that § 1337 gives equity powers to aid in the enforcement of legislative policies. *United States v. Shafer,* 132 F.Supp. 659 (D. Md. 1955), involved solely the issue of whether a court can issue an injunction to enforce regulations of the Department of Agriculture without express legislative authorization. *I.A.M. v. Central Airlines, Inc.,* 372 U.S. 682 (1963); *United States v. West Virginia,* 295 U.S. 463 (1935); *Texas & N.O.R. v. Ry. Clerks,* 281 U.S. 548 (1930); *Sanitary District v. United States,* 226 U.S. 405 (1925); *In re Debs,* 158 U.S. 564 (1895); *Florida East Coast Ry. v. U.S.,* 348 F.2d 682 (5th Cir. 1965); *Shafer v. U.S.,* 229 F.2d 124 (4th Cir. 1956) hold that courts of equity can issue injunctions despite the absence of any express statutory authority. Not a single case referred to above involved the problem of a specific jurisdictional statute conflicting with a general jurisdictional statute. *Leedom v. Kyne,* 358 U.S. 184 (1958) is another case where there was no conflict in statutes. The Court held that a district court had jurisdiction under 28 U.S.C. § 1337 to set aside the Board's determination of a bargaining unit, where the Board clearly acted in direct violation of Section 9 of the Act.

discuss the issue. The Board admits, and argues, that the instant subpoena is related to a hearing or investigation under Section 9 of the Act. It is clear that Section 11 is a specific statute governing enforcement of subpoenas related to such a hearing or investigation, and specifically covers subpoeans related to enforcement of election rules, based on Section 9. Under the rule of construction discussed above, it is clear that 28 U.S.C. § 1337 can not be used to enforce the instant subpoena.

Even if it is determined that the Court has power to enforce the subpoena under 28 U.S.C. § 1337, this Court should remand the case to the District Court for decision on this issue. The District Court specifically refused to rule on the count in the complaint involving 28 U.S.C. § 1337. This Court should not decide this issue until it has been passed on by the court below.

It is well settled that the granting of an injunction, the relief requested by the Board under 28 U.S.C. § 1337, is a matter for the discretion of the District Judge acting as Chancellor. *United States v. W. T. Grant Co.,* 345 U.S. 629 (1953); *United States v. Board of Education of Greene County,* 332 F.2d 40 (5th Cir. 1964); *Esquire Inc. v. Esquire Slipper Manufacturing Co.,* 243 F.2d 540 (1st Cir. 1957).

In *Oser v. Wilcox,* 338 F.2d 886 (9th Cir. 1964), this Court held that a matter involving the exercise of discretion by a District Court Judge will be remanded to the District Court for determination before it is passed upon by the Court of Appeals.

Judge Coffin, in his dissenting opinion in *Wyman-Gordon,* No. 2000 (1st Cir. June 12, 1968), 119 BNA Daily Labor Rep. at A-1 (June 18, 1968), felt that the *Excelsior* rule was not enforceable under Section 11 of the Act. Since the District Judge had not ruled on the

Section 1337 ground, he stated that this issue should have been remanded for consideration by the District Judge.

The cases cited by the Board are inapplicable. *M.O.S. Corporation v. John I. Haas Co.,* 375 F.2d 614 (9th Cir. 1967), and *S & S Logging Co. v. Barker,* 366 F.2d 617 (9th Cir. 1966) did not involve issues requiring an exercise of the District Court's equitable discretion.

Therefore, it is clear that even if this Court were to determine that the instant subpoena could be enforced under 28 U.S.C. § 1337, the matter should be remanded to the District Court. However, even if the Court were to rule the 28 U.S.C. § 1337 were applicable, and also decide not to so remand this issue, it is submitted that this Court should not exercise its discretion to enforce the subpoena.

The Court should not exericse its discretion until the appellant has had a hearing before the Board on the issue of the validity of the *Excelsior* rule as applied in the instant case. The appellant has requested such a hearing and is prepared to demonstrate that the Union had ample access to employees, and that under the facts of the instant case, the *Excelsior* rule should not have been applied.

The proper forum to initially hold a hearing on the validity of the *Excelsior* rule, as applied to in the instant case, is the Board, which was established by Congress to become expert with respect to industrial relations matters. The Board is seeking to circumvent holding a hearing at which *Excelsior* could be properly tested.

Congress has provided the Board with other means to enforce the *Excelsior* rule. It can, and has, set aside an election where the rule has veen violated. The Board can, and on numerous occasions has, ordered multiple elections in order to effectuate its rules concerning the

validity of elections. In addition, the Board can act pursuant to Section 8(a) of the Act, and proceed on the theory that the appellant has committed an unfair labor practice. If this were done, the appellant would have a right to a hearing at which time could fully present its views and position with respect to the *Excelsior* rule. In addition, if after such a hearing it was determined that the appellant violated a provision of Section 8(a) of the Act, the Board could issue an appropriate order, which a federal court would have the power, as authorized by Congress, to enforce. The Board has not shown that there is any reason for the Court to exercise its extraordinary power to grant an injunction.

It is therefore clear that there is no basis to enforce the subpoena under 28 USC § 1337.

CONCLUSION

For the reasons hereinabove set forth, the Court should reverse the decision to the lower court, and order the instant action dismissed.

Respectfully submitted,
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Wesley Sizoo

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Attorneys for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

SEYMOUR SWERDLOW

Seymour Swerdlow

No. 2355

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

EZRA J. NIXON and
LARUE O. NIXON,

Appellants,

vs.

H. W. HEERS and
H. W. HEERS, INC.,
a Corporation,

Appellees.

On Appeal From the United States District Court
For The Central District of California

APPELLANTS' BRIEF

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STATEMENT OF JURISDICTIONAL FACTS

Jurisdiction of the Federal Court in this case is found on diversity of citizenship between the parties (§1332, Title 28, United States Code).

Appellants (plaintiffs in the court below) are residents and citizens of the State of Utah. (See complaint R. 2, and Finding No. 1, R. 114). Appellee H.

H. W. Heers, Inc., (one of the defendants) is a corporation organized under the laws of California, with its principal place of business there; and Appellee H. W. Heers individually (the other defendant) is a resident and citizen of the State of California. (See Complaint R. 2, and Finding No. 2, R. 114, 115).

Likewise, the amount in controversy exceeds the sum of $10,000., exclusive of interest and costs. (See Complaint, R. 2, and Finding of Fact No. 3, R. 115).

STATEMENT OF THE CASE

Appellants brought this action in the United States District Court for the Central District of California to recover the balance of $107,500., plus interest, attorney fees, and costs, owing by Appellees on a certain promissory note executed and delivered in Utah by Appellees to Appellants.

The complaint filed in the lower court alleges, and the trial court specifically found, that "on or about September 20, 1961, for a valuable consideration * * * *, * *, defendants, H. W. Heers and H. W. Heers, Inc., made, executed, and delivered to the plaintiffs in the State of Utah their promissory note in the principal sum of $171,563.66." (R. 115).

The promissory note provided in part that "All payments whether of principal or interest are to be paid either in cash, or at the election of the promisor, in notes secured by deeds of trust; provided, however, that the election to pay any installment or any part thereof in notes shall not constitute an election to pay the balance, whether of principal or of interest, in notes." (R. 116)

One installment was paid by Appellees, after which no payments were made, thereby requiring Appellants to take legal action, which was done. (R. 117, 118). Appellants first proceeded to foreclose their second mortgage on the property through the courts in Utah. (R. 118, 119). The proceeds derived from the Sheriff's sale, which was duly and regularly held, were applied on the indebtedness owing, resulting in an unpaid balance owing on said promissory note of $107,500., together with $19,229.69 interest to July 17, 1965. (R. 119, 120).

The trial court further found that under the law of the State of Utah, where the note was executed and made payable, a maker of a note secured by a mortgage on real property is not exonerated from payment of the note by the foreclosure of the mortgage and that "a deficiency judgment is authorized and permitted." (R. 120).

SPECIFICATION OF ERRORS

The sole issue to be determined by this appeal is whether the trial court erred in finding (and thereafter incorporating such finding in the Conclusions of Law and Judgment) that the principal amount of the note, together with accrued interest thereon, "may be paid and satisfied by defendants' delivery to plaintiffs bona fide notes secured by valid deeds of trust." (R. 120).

ARGUMENT

THE TRIAL COURT ERRED IN PERMITTING APPELLEES TO PAY THE PRINCIPAL AND INTEREST OWING ON THE NOTE BY "DELIVERY TO PLAINTIFFS BONA FIDE NOTES SECURED BY VALID DEEDS OF TRUST."

As hereinbefore stated, the promissory note which Appellees executed and delivered to Appellants contained a provision that payments of either principal or interest were to be made "either in cash, or at the election of the promisor, in notes secured by deeds of trust; provided, however, that the election to pay any installment or any part thereof in notes shall not constitute an election to pay the balance, whether of principal or of interest, in notes." (R. 116).

Although Appellees failed to raise any issue on the mode or right of election of payment, (nor was any such issue framed in the Pre-Trial Conference Order) the trial court at the time of rendering its decision from the Bench, commented:

> "Supposing I find in favor of the plaintiff and order payment. Why can't I, in ordering payment, follow the terms of your contract and say that the payments of the balance due should be in cash or in notes secured by deeds of trust? I would like to have your opinion on that." (Tr. 191, 192)

After discussing the matter with the Court, Counsel for Appellants responded:

> "The position we take, at this point, is that he is no longer in a position to exercise that." (Tr. 196)

Counsel further argued:

> ". . . he has come into court and has denied that he is liable for any payment and has not set up as any defense that he is entitled to pay it in any other manner than in cash.
>
> "So, we maintain that he should be required to pay in cash." (Tr. 197)

After counsel later advised the court that "we sued for a specific amount of money and the issue that was framed at the pre-trial was what was the amount that was unpaid at that time on the note," the Court decided:

> "THE COURT: I am going to find that there is so much due in money, but payment can be made either in cash or in trust deeds.
>
> "MR. NIELSEN: Well, I submit, as I said, your Honor, that we feel that the defendant has no right at this time to assert a claim.
>
> "THE COURT: I assume that you have a perfect right to take this up to the Circuit and if I have been wrong, the Circuit will have no hesitancy in telling me so.
>
> "Now, there is one other question here which should be solved and that is the question of attorney's fees. Now, the contract doesn't say anything about paying attorney's fees in trust deeds, so the attorney's fees will be paid in cash." (Tr. 198)

Since no issue had been raised in the pleadings or pre-trial order as to the right of Appellees to pay the note

in any other manner than by cash, very little evidence in the case appears in the Record. However, at the outset of the trial it was stipulated between the parties that if the plaintiff Ezra J. Nixon were called as a witness he would testify as to the payments made, and the dates, with the computations of the balance owing together with interest, all as set forth in the Transcript. (See pp. 49, 50).

Later during the trial the court inquired of Mr. Nixon as to whether any payments had been made by Appellees or anyone else on the note after January 2, 1962, to which the witness responded, "Nothing." (Tr. 160).

The general statement of the law applicable to the situation now before the Court is contained in 40 Am. Jur. PAYMENT, §63, pp. 758, 759, as follows:

> "It is a rule of law that a person who has reserved to himself the right to discharge his obligation under a contract in two or more different ways may elect, at any time before the day of payment has passed, in which way he will discharge it. If he exercises this option by making tender of performance and doing all that it is in his power to do, he cannot be deemed to have lost his right. On the other hand, where a promise is in the

alternative to pay a definite sum of money or its equivalent in property, the promisor has an election either to pay in money or the equivalent, but if he fails to pay in property on the day of payment, the right of election is gone and the promisee is entitled to payment in money. The money in such cases is the primary element of the promise, and a stipulation that it may be discharged by something else is an alternative that the maker may avail himself of at or before the day of payment. If he fails to do so, the primary object of the promise must prevail, and it becomes a moneyed demand. The reason for the rule is that the creditor might reasonably calculate on the value of the property at a particular day. But if it were left to the debtor at his election to make delivery at any indefinite period afterward, he might select that time at which the value of the property would be most depreciated, and thus gain an advantage inconsistent with his contract."

Authorities cited in support of the proposition that if the promisor has an election either to pay in money or in property and fails to pay in property on or before the day of payment, "the right of election is gone and the promisee is entitled to payment in money", include the following:

Texas & R. P. Co. v. Marlor, 123 U.S. 687, 8 S. Ct. 311, 31 L. Ed 303; Trebilcock v. Wilson, 12 Wall. (U.S.) 687, 20 L. Ed 460; Central Trust Co. v. Richmond, N.I. & B.R. Co., (CCA 6th), 68 F. 90, 41 LRA 458, Cert. Den. 163 U.S. 679, 16 S. Ct. 1199, 41 L. Ed 310; Beckwith v. Sheldon, 168 Cal. 742, 145 P. 97, Ann Cas 1916A 963; Cummings v. Dudley, 60 Cal. 383, 44 Am. Rep. 58; and others.

In the Texas & P.R. Co. case, the decision of the Supreme Court of the United States is well summarized in the headnote, as follows:

> "(1) If the Company did not pay the interest in money by the interest day, it was bound to exercise, by that day, its option to pay it in scrip, and, if it did not, it became liable to the bondholders to pay the interest in money; (2) no demand by a bondholder was necessary, in order to entitle him to the payment of the interest in money, on

the failure of the Company so to exercise such option."

In Beckwith v. Sheldon, supra, the Supreme Court of California held similarly:

"(1, 2) Looking to the terms of the agreement, it is easily seen that it is not a mere agreement for the delivery of bonds. The promise is 'that there shall be paid to' Beckwith 'the sum of $59,000.' This is not an agreement to sell or deliver bonds, but a promise to pay money. The addition of the words 'in bonds of the *** company, at par' does not change it into an agreement solely for the delivery of the bonds, but merely gives the payor the option or privilege of making such payment by delivering the bonds as specified when the time of performance arrived. The defendant Central Canal & Irrigation Company, having received the consideration furnished to the enterprise by Beckwith, and having undertaken to perform the obligation to him set forth in the agreement, was bound thereby to the same extent as if it had been a party thereto. When it thereupon refused to perform the obligation,

the promise became an absolute money obligation, and the value of the bonds was immaterial, or at all events the payment in money became immediately due (Brown v. Foster, 51 Pa. 173), and the payee could sue thereon as upon a money obligation, and recover without alleging or proving the value of the bonds."

The Supreme Court of Utah has followed the rule laid down by the Supreme Court of the United States in the Texas & P.R. Co. case. In Meissner v. Ogden, L. & I. Ry. Co., 65 U 1, 233 P. 569, the Court stated:

"By the terms of the notes the Company was obligated to pay the sums named on or before January 21, 1921, with the option to convert the notes into bonds. In substance, the Company had the election to pay the notes in money or in bonds, and its undertaking, in point of time, was to pay in one way or the other on or before January 2, 1921. In Haskins v. Dern, 19 Utah 89, 56 P. 953, Mr. Justice Miner of this court said:

"' Where a debtor has the election to pay either money or property, if he fails to make tender at the time fixed for payment,

he thereby loses his election, and the obligee has the right to demand the money.'"

In the case now before the Court, the trial judge found that after paying the first installment due on the promissory note, Appellees made no further payments on the note. "Neither defendants H. W. Heers or H. W. Heers, Inc., nor their successors in interest, tendered or offered to tender to the plaintiffs herein any payment on said note by way of cash or bona fide notes secured by valid deeds of trust, and not withstanding repeated demands, failed and refused to pay the amount owing under said note and particularly the yearly payment due and payable thereon beginning with September 1, 1962." (Finding No. 11, R. 118).

In view of the foregoing, there appears to be no justification for the trial court permitting Appellees the continued option to pay the promissory note by delivery to Appellants "bona fide notes secured by valid deeds of trust."

ADDITIONAL ATTORNEY FEES

The trial court further found that Appellants were entitled to their attorney fees incurred in connection with the instant action and determined the sum of $13,000.00 to

be a reasonable amount to be awarded. Since no provision was made for any attorney fees on appeal of this matter, Appellants respectfully request this Court to increase the amount of attorney fees by a reasonable sum to compensate Appellants for the fees incurred in connection with this appeal.

CONCLUSION

Appellants respectfully submit that the Judgment of the lower court should be modified to delete therefrom any right on the part of Appellees to pay and satisfy the judgment or any part thereof by delivery to Appellants of "bona fide notes secured by valid deeds of trust," and thereby enter a money judgment in favor of Appellants and against Appellees in a specific amount, together with interest costs, and attorney fees (including such additional amount for attorney fees as this Court shall deem appropriate for the prosecution of this appeal), together with Appellants' costs on appeal.

Respectfully submitted,

ARTHUR H. NIELSEN and
FRANCIS RAY BROWN

Attorneys for Appellants.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Francis Ray Brown

FRANCIS RAY BROWN

No. 22,356

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN C. VAN HOUTEN,

Appellant,

v.

RAY ARTHUR RALLS and GERALD L. BYINGTON,

Appellees.

**ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA**

BRIEF FOR THE APPELLEES

EDWIN L. WEISL, Jr.
Assistant Attorney General,

JOSEPH L. WARD
United States Attorney,

MORTON HOLLANDER,
WILLIAM KANTER,
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I N D E X

CITATIONS

ases:

Cases:

IN THE UNITED STATES COURT OF APPEALS
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JOHN C. VAN HOUTEN,

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RAY ARTHUR RALLS and GERALD L. BYINGTON,

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

BRIEF FOR THE APPELLEES

JURISDICTIONAL STATEMENT

This action was instituted by the appellant, Van Houten, in Seventh Judicial District Court of the State of Nevada, nty of White Pine, to recover for injuries allegedly caused the improper driving of appellees Ralls and Byington, govern- t employees (R. 7-12). The action was thereafter removed to United States District Court for the District of Nevada, pur- nt to subsection (d), the Federal Drivers Act, 28 U.S.C. 9(d) (R. 2-5). The district court granted appellees' motion dismiss on the ground that the Federal Drivers Act, 28 U.S.C. 9(b) - (e) protected them against liability arising out of

driving in the course of their government employment (R. 71-
The jurisdiction of this Court rests on 28 U.S.C. 1291.

STATEMENT OF THE CASE

On June 14, 1966, before instituting the present suit, a
pellant Van Houten brought an action against appellees Ralls
Byington, and the United States, in the United States Distri
Court for the District of Nevada (Civil No. 1838) (R. 82-87)
In his complaint Van Houten alleged that he was injured on D
ber 1, 1964, while riding as a passenger in Byington's car,
a time when both he and Byington were on government business
The accident allegedly occurred when Byington's car collided
with a vehicle being driven by Ralls, who was also in the co
of his government employment, and because of the negligence
Ralls, Byington, or both. Van Houten sought damages of
$295,320.27 from the United States (under the Federal Tort Ca
Act, 28 U.S.C. 1346(b), 2671 et seq.,) and from Ralls and By

On January 6, 1967, the district court granted the gover
ment's motion for summary judgment as to Van Houten's suit u
the Tort Claims Act, on the ground that his exclusive remedy
against the United States lay under the Federal Employees Co
sation Act, 5 U.S.C. 751 et seq. And the Court dismissed
Van Houten's action as to Ralls and Byington for lack of fed
jurisdiction (R. 123-133). Judgment was accordingly entered
January 10, 1967 (R. 134).

In the meantime, however, Van Houten, on November 29, 1
filed the present action against Ralls and Byington in the S

dicial District Court of the State of Nevada, County of White ne (No. 8957) (R. 7-11). In this action Van Houten asserted sentially the same factual allegations as to Ralls and Byington he had asserted in his action in the United States District urt, and again sought judgment for $295,320.27.

Thereafter, Ralls,[1/] through the United States Attorney, titioned the United States District Court for the District of vada for removal of the action pursuant to subsection (d) of e Federal Drivers Act, 28 U.S.C. 2679(d) (R. 3-5). That peti- on asserted that Ralls and Byington were acting in the scope their government employment at the time of the accident, and at therefore pursuant to the Federal Drivers Act, Van Houten's medy lay against the United States under the Federal Tort aims Act, 28 U.S.C. 1346(b). In support of that petition, and rsuant to 28 U.S.C. 2679(d), the United States Attorney certi- ed that at the time of the accident Ralls was in the scope of s government employment.

After removal, Van Houten moved to remand the case to the ate Court for trial against Ralls and Byington, individually sertedly pursuant to 28 U.S.C. 2679(d) (R. 17-19). Ralls and ington through the United States Attorney cross-moved for a smissal of the action on the ground that the Drivers Act immun- ed them from all personal liability arising out of driving in e course of their government employment (R. 20-22).

1/ Apparently, Byington had not yet been served with process in e State Court action (R. 3).

On August 31, 1967, the district court accepted the Uni States' position and held that Van Houten's action against R and Byington should be dismissed (R. 71-75). The court rule that to deprive Ralls and Byington of the protection of the Drivers Act

> is to attribute to Congress an intent when it adopted the Government Drivers Act amendment to the Federal Tort Claims Act which affronts common sense. Under that interpretation, a federal employee driver of a motor vehicle in the course of his employment is normally exonerated from personal liability, but not so if the injured person is another federal employee who has a claim for compensation under the Federal Employees Compensation Act. An intent to engraft such an incongruous exception to the general immunity from personal liability cannot be found in the language of the statute nor in the legislative history.

Judgement dismissing the action was filed on September 1967 (R. 75). This appeal followed (R. 78).

STATUTES INVOLVED

The Federal Tort Claims Act, 28 U.S.C. 1346(b), 2671 et provides in pertinent part:

> 1346(b) Subject to the provisions of chapter 171 of this title, the district courts * * * shall have exclusive jurisdiction of civil actions on claims against the United States, for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred.

The Federal Drivers Act, 28 U.S.C. 2679(b)-(e), provide pertinent part:

Subsection (b), 28 U.S.C. 2679(b):[2/]

> The remedy by suit against the United States as provided by section 1346(b) of this title for damage to property or for personal injury, including death, resulting from the operation by any employee of the Government of any motor vehicle while acting within the scope of his office or employment, shall hereafter be exclusive of any other civil action or proceeding by reason of the same subject matter against the employee or his estate whose act or omission gave rise to the claim.

Subsection (c), 28 U.S.C. 2679(c):

> The Attorney General shall defend any civil action or proceeding brought in any court against any employee of the Government or his estate for any such damage or injury. The employee against whom such civil action or proceeding is brought shall deliver within such time after date of service or knowledge of service as determined by the Attorney General, all process served upon him or an attested true copy thereof to his immediate superior or to whomever was designated by the head of his department to receive such papers and such person shall promptly furnish copies of the pleadings and process therein to the United States Attorney for the district embracing the place wherein the proceeding is brought, to the Attorney General, and to the head of his employing Federal Agency.

Subsection (d), 28 U.S.C. 2679(d):

> Upon a certification by the Attorney General that the defendant employee was acting within the scope of his employment at the time of the incident out of which the suit

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Subsection (b) was amended by P. L. 89-506, July 18, 1966, 80 at. 306, 307, to reflect inter alia the new requirement that l Tort Claims be presented for administrative consideration ior to commencement of suit under the Tort Claims Act. See 28 S.C. (Supp. II) 2401(b), and 2672. The amended provision, 28 S.C. (Supp. II) 2679(b) which contains some other minor changes, plies to claims accruing six months or more after July 18, 1966, d is therefore inapplicable here.

> arose, any such civil action or proceeding commenced in a State court shall be removed without bond at any time before trial by the Attorney General to the district court of the United States for the district and division embracing the place wherein it is pending and the proceedings deemed a tort action brought against the United States under the provisions of this title and all references thereto. Should a United States district court determine on a hearing on a motion to remand held before a trial on the merits that the case so removed is one in which a remedy by suit within the meaning of subsection (b) of this section is not available against the United States, the case shall be remanded to the State court.

The Federal Employees' Compensation Act, 5 U.S.C. 751 et seq. (now 5 U.S.C. (Supp. II) 8101 et seq.) provides in pertinent part (Section 757(b)):[3/]

> The liability of the United States or any of its instrumentalities under sections 751-756, 757-781, 783-791 and 793 of this title or any extension thereof with respect to the injury or death of an employee shall be exclusive, and in place, of all other liability of the United States or such instrumentality to the employee, his legal representative, spouse, dependents, next of kin, and anyone otherwise entitled to recover damages from the United States or such instrumentality, on account of such injury or death, in any direct judicial proceedings in a civil action or in admiralty, or by proceedings, whether administrative or judicial, under any other workmen's compensation law or under any Federal tort liability statute: Provided, however, That this subsection shall not apply to a master or a member of the crew of any vessel.

3/ Title 5 of the United States Code has been recodified, and the F.E.C.A. is now found at 5 U.S.C. (Supp. II) 8101 et seq. 5 U.S.C. 757(b), with minor modifications, is now found at 5 U.S.C. (Supp. II) 8116(c).

ARGUMENT

THE DISTRICT COURT CORRECTLY HELD THAT THE FEDERAL DRIVERS ACT BARS VAN HOUTEN'S SUIT AGAINST RALLS AND BYINGTON AS A MATTER OF LAW.

The Federal Drivers Act, 28 U.S.C. 2679(b)-(e), was enacted n 1961 to relieve government drivers of the necessity of purhasing private insurance to cover their government driving, and o protect all government drivers from the threat and burden of uits and judgments resulting from driving for the government. ee H. Rept. No. 297, 87th Cong., 1st Sess.; S. Rept. No. 736, 7th Cong., 1st Sess.; 107 Cong. Rec. 18,499-18,500, 87th Cong., st Sess. The Federal Drivers Act accomplishes this by making the remedy against the United States provided by the tort claims rovisions of that title [28 U.S.C. 1346(b)] for damage to proerty, personal injury or death resulting from the operation of motor vehicle by an employee of the United States within the cope of his employment . . . exclusive of any other civil action r proceeding by reason of the same subject matter against the mployee involved or his estate." H. Rept. No. 297, supra, pp. -2. And the statute was plainly intended to "exclude suits gainst employees in their individual capacities on the same laims." Id. at p. 4 (emphasis added).

In accordance with the Congressional purpose, 28 U.S.C. 679(b) provides in unambiguous language that "[t]he remedy by uit against the United States as provided by section 1346(b) of his title [Federal Tort Claims Act] for damage . . . or . . . njury . . . resulting from the operation by any employee of the

Government of any motor vehicle while acting within the scope o his office or employment, shall hereafter be exclusive of any other civil action or proceeding by reason of the same subject matter against the employee . . . whose act . . . gave rise to the claim." (Emphasis added.) Thus, the statute accomplishes the Congressional purpose of protecting individual drivers fro personal suits and judgments arising out of driving in the cour of their employment by limiting the plaintiff to his remedy aga the United States under 28 U.S.C. 1346(b), the Federal Tort Cla Act.

Subsection (b) of the Drivers Act, 28 U.S.C. 2679(b) is th "basic provision of the bill." H. Rept. No. 297, supra, p. 4. In order to implement subsection (b)'s plain command that the e clusive remedy in all of these cases shall be under the Tort Claims Act against the United States, the Act insures that ac- tions such as the present one, which are instituted in State courts against government drivers individually, are to be re- moved to the United States district court and are to proceed as actions against the United States under the Federal Tort Claims Act. Thus subsection (d), 28 U.S.C. 2679(d), provides that whe the Attorney General certifies that the defendant driver "was acting within the scope of his employment at the time of the in cident out of which the suit arose", the state court action is to be removed to the appropriate United States district court and "the proceedings deemed a tort action brought against the United States" under the Federal Tort Claims Act.

Of course, after such a removal, there remains the possibl

at, during pre-trial proceedings in the United States district urt, a fuller development of the evidence might convince the urt that the Government driver was not acting within the scope his official employment and hence that there was no Tort aims Act remedy, in fact, available against the United States. e Tort Claims Act expressly limits federal liability to claims used by negligence on the part of a Government employee "while ting within the scope of his office or employment." 28 U.S.C. 46(b). But if the employee, at the time of his alleged tort, s not so acting, the Tort Claims Act is inapplicable and the urt would lack jurisdiction to entertain the claim against the ited States. United States v. Eleazer, 177 F. 2d 914 (C.A. 4), rtiorari denied, 339 U.S. 903.

The Federal Drivers Act takes into account this latter contingency, i.e., that the driver may have been outside the scope his employment at the time of the accident. Subsection (d) ovides that if the district court should "determine on a hearg on a motion to remand held before a trial on the merits that e case so removed is one in which a remedy by suit within the aning of subsection (b) of this section [28 U.S.C. 2679(b)] is t available against the United States, the case shall be reanded to the State court."

Thus, in line with the Congressional plan and for the purpose the remand provision in subsection (d) of the Federal Drivers t, it is clear that a Tort Claims Act remedy "is not available ainst the United States" only where the Government driver is termined by the Court to have been acting outside the scope of

his employment.[4/] And, as a necessary corollary, where the Tor Claims Act remedy is "not available" for some reason other tha lack of scope of employment, there can be no personal liabilit on the part of the driver, and the remand provision does not apply.

In the present case, therefore, the district court proper determined that the remand provision of subsection (d) did not apply, and that Ralls and Byington continued to enjoy the prot tion of the Drivers Act. For Van Houten's Complaint made it clear that Ralls and Byington were driving within the scope of their employment at the time of the accident, and the remand c viously was not sought on the ground of any alleged lack of sc employment. Rather, Van Houten sought remand because the Tort Claims Act was unavailable to him by virtue of the exclusivit provisions of the F.E.C.A., 5 U.S.C. 757(b) (R. 17-19).

In these circumstances, since the non-availability of th Tort Claims Act remedy to Van Houten stems from the exclusivi provisions of the F.E.C.A., rather than from absence of any s of employment on the part of Ralls and Byington, the latter s enjoy the protection of the Drivers Act and the remand provis

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4/ The legislative history of the Drivers Act emphasizes the fact that Congress intended its protection to extend only to drivers who were on government business. H. Rept. No. 297, s p. 4, states: "the new language [of 28 U.S.C. 2679(b)] would only apply when the employee is acting in his official capacit at the time of the accident giving rise to the claim, and doe not provide the basis for any liability against the United St based on the unauthorized use of Government motor vehicles."

inapplicable.[5] In other words, in light of the Drivers Act, Van Houten has no action against Ralls and Byington as a matter of law and the district court properly refused to remand the case for trial against them individually.

Any other result would have nullified the immunity against damage suits which Congress intended to confer on federal drivers with respect to all claims based on their driving while on Government business. And the district court's view is strongly reinforced by the pertinent legislative history establishing that Congress set out to provide a comprehensive shield to Government drivers, so as to wholly remove the threat of personal liability, and improve the morale of government drivers. H. Rept. No. 297, supra, pp. 3-4.[6]

/ The result here is, therefore, to limit Van Houten to his compensation remedy under the F.E.C.A. That result is however by no means unique. Larson reports that a number of state workmen's compensation statutes themselves prohibit tort suits both against employers and negligent fellow employees. 2 Larson, Workmen's Compensation Law § 72.20, pp. 173-174.

Furthermore, the Supreme Court has noted the clear advantages to a claimant of the comprehensive system of benefit payments under the Act. Johansen v. United States, 343 U.S. at 440-441. Compare Feres v. United States, 340 U.S. 135, 145. In addition, we point out that benefit payments under the F.E.C.A. may be quite substantial. Under the Act, benefits up to approximately $1600 per month may be payable during an employee's disability. 5 U.S.C. (Supp. II) Appendix 756(c).

/ Indeed, the bill as it emerged from the Senate Judiciary Committee would have permitted a plaintiff a choice as to whether his action was to be removed to Federal Court for trial under the Tort Claims Act. S. Rept. No. 736, 87th Cong., 1st Sess., pp. 5, 8. A similar provision led to a Presidential veto in 1960. House Misc. Documents, 86th Cong., 2d Sess., Document No. 415. On the Senate floor, the provision of the bill granting an option to plaintiff was deleted, and instead a proposal by Senator Keating was adopted which provided for mandatory removal of these actions upon certification by the Attorney General that the Driver

(Continued on next page)

In this connection, it is significant that the GSA, whic drafted the Bill and repeatedly urged its passage, was primar concerned with the high cost of liability insurance Governmen drivers incurred just to protect themselves from personal act See H. Rept. No. 297, supra, p. 7. This concern was repeated Senator Keating on the Senate floor. 107 Cong. Rec. 18499-50 87th Cong., 1st Sess. Obviously, if the driver is not fully mune from liability for damages resulting from driving in the course of his employment, he must still bear a heavy insuranc burden and must still drive at the risk of suit and personal ability -- risks Congress fully intended to eliminate.

Moreover, the decided cases attest still further to the rectness of the district court's decision. Thus, two other d trict courts have recently held that the Drivers Act fully im izes government drivers from liability arising from driving o government business, even where as here the injured plaintiff no action against the United States under the Tort Claims Act virtue of the exclusivity provisions of the Federal Employees Compensation Act. Vantrease v. United States, (W.D. Mich., N. 5469, decided August 29, 1967) pending on appeal;[7] Beechwoo United States, 264 F. Supp. 926 (D. Mont.). See Noga v. Uniti

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6/ (Continued from previous page)
was in the scope of his employment. 107 Cong. Rec. 18499-500 In the words of Senator Keating, the bill as adopted "makes cr tain that suits will not be removed improperly, but protects h employee from any personal liability where it is conceded tha was acting within the scope of his employment." Id. at 18500

7/ For the convenience of the Court we have reproduced a cop of the Vantrease decision in the appendix to this brief, infr pp. 1a-11a.

ates, 272 F. Supp. 51 (N.D. Calif.), pending on appeal to this urt, No. 22,165.[8/] Similarly, in Hoch v. Carter, 242 F. Supp. 3 (S.D.N.Y.); Reynaud v. United States, 259 F. Supp. 945 (W.D. .); and Fancher v. Baker, 240 Ark. 288, 399 S.W. 2d 280, the urts held the government driver immune from liability in situa- ons where the Tort Claims Act remedy was unavailable to plain- ff because of the expiration of the limitations period.

Appellant's reliance upon Weyerhaeuser S. S. Co. v. United ates, 372 U.S. 597, for the proposition that the Drivers Act ould not apply here, is entirely misplaced. In Weyerhaeuser e Court found no evidence that Section 7(b) of the F.E.C.A. s intended to modify the historic rule of divided damages ap- icable in maritime collision cases, and therefore upheld the vision of damages between the United States and a private ship- ner. In the present case, however, we are dealing with the ederal Driver's Act, and both the language and legislative his- ory of that Act show conclusively that the very purpose of Con- ress was to abrogate the tort recovery formerly available

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8/ But see also Gilliam v. United States, 264 F. Supp. 7, (E.D. .), pending on appeal, where the district court in nearly iden- ical circumstances to this case implicitly accepted the govern- ent's position that the Driver's Act fully protected the driver, t entered judgment against the United States under the Tort laims Act. We think that the district court in Gilliam should ve dismissed the action outright, and we have taken an appeal the United States Court of Appeals for the Sixth Circuit.

against government drivers. Moreover, as this Court has, in e. fect, twice held, the principle of the Weyerhaeuser decision i limited to maritime collision cases, or perhaps to cases where the United States undertakes an independent contractual obliga tion to some third party. United Air Lines, Inc. v. Wiener, 3 F. 2d 379, 402-404, certiorari dismissed, sub nom., United Air Lines v. United States, 379 U.S. 951; Wien Alaska Air Lines v. United States, 375 F. 2d 736 (C.A. 9), certiorari denied, 389 U.S. 941. Accord: Maddux v. Cox, 382 F. 2d 119 (C.A. 8). Weyerhaeuser, therefore, plainly has no application here. 9/

To sum up, therefore, we submit that the language, purpos and legislative history of the Drivers Act and the pertinent d cisions support the district court's conclusion that Van Houte has no cause of action against Ralls and Byington.

9/ Appellant's reliance upon Allman v. Hanley, 302 F. 2d 559 (C.A. 5) and Marion v. United States, 214 F. Supp. 320 (D. Md. is also misplaced, for those cases merely hold that the F.E.C. does not prohibit a suit by one federal employee against anoth but neither case deals with the Federal Drivers Act, which, ur like the F.E.C.A., does prohibit a suit against a co-employee for negligent driving in the course of his government employme

Moreover, appellant's contention (Br. 7-8) with respect t the letters from the Department of Labor (R. 64-68) must be re jected, for those letters reflect nothing more than a suggesti that Van Houten "may" have a tort suit, and do not reflect the Department of Labor's full knowledge of the facts or its commi ment that a tort remedy was in fact available. The letters appear, rather, to be in the nature of form letters.

CONCLUSION

For the foregoing reasons, the judgment of the district urt dismissing appellant's complaint should be affirmed.

Respectfully submitted,

EDWIN L. WEISL, Jr.
Assistant Attorney General,

JOSEPH L. WARD
United States Attorney,

MORTON HOLLANDER,
WILLIAM KANTER,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

GUST 1968

CERTIFICATE

I certify that, in connection with the preparation of this ief, I have examined Rules 18, 19 and 39 of the United States urt of Appeals for the Ninth Circuit, and that, in my opinion, e foregoing brief is in full compliance with those rules.

William Kanter

WILLIAM KANTER
Attorney,
Department of Justice,
Washington, D.C. 20530.

AFFIDAVIT OF SERVICE

STRICT OF COLUMBIA)
) ss.
TY OF WASHINGTON)

WILLIAM KANTER, being first duly sworn, deposes and says:

That on August 9 , 1968, he caused three copies of the regoing brief for the appellees to be served by air mail,

stage prepaid, upon counsel for appellant:

George W. Abbott, Esquire
First National Bank Building
Minden, Nevada 89423

William Kanter

WILLIAM KANTER
Attorney,
Department of Justice,
Washington, D.C. 20530.

bscribed and sworn to before me
ls 9th day of August 1968.

[SEAL]

Caroline Johns

NOTARY PUBLIC

Commission expires April 14, 1972.

A P P E N D I X

IN THE UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF MICHIGAN

SOUTHERN DIVISION

SAMMY J. VANTREASE, Plaintiff, vs. UNITED STATES OF AMERICA, Defendant.	)	Civil Action No. 5469

Before HON. W. WALLACE KENT, Chief Judge.

Kalamazoo, Michigan, August 29, 1967.

OPINION OF THE COURT

ANTOINETTE DUDA
Official Court Reporter
418 Federal Building
Grand Rapids, Michigan

IN THE UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF MICHIGAN

SOUTHERN DIVISION

SAMMY J. VANTREASE, Plaintiff, vs. UNITED STATES OF AMERICA, Defendant.	)	Civil Action No. 5469

Before HON. W. WALLACE KENT, Chief Judge.

Kalamazoo, Michigan, August 29, 1967.

APPEARANCES:

MARCUS, McCROSKEY, LIBNER, REAMON, WILLIAMS & DILLEY, Grand Rapids, Michigan, By MR. J. WALTER BROCK,

on behalf of the Plaintiff;

MR. JAMES W. EARDLEY, Assistant United States Attorney,

on behalf of the Defendant.

THE COURT: This is the government's motion for a summary judgment, on the ground that the suit by the plaintiff is barred by the provisions of Title 28, U.S.C.A., Section 2679(b).

The case could be disposed of summarily by pointing out that in the file there appear the following: A complaint filed in the Circuit Court for Calhoun County; the usual papers filed on removal; a motion for substitution, which has been previously decided; an answer filed by the United States, which was substituted for the defendant Dorr Cameron; and a motion for judgment on the pleadings and a motion for summary judgment. There is no motion for remand, although the point was made during the course of the arguments on the motion for substitution of defendants.

Briefly, the cause of action arises out of an occurrence on December 8, 1964, when the plaintiff was injured while working as a Post Office employee when struck by an automobile driven by Dorr Cameron, a Post Office employee driving in the scope of his employment.

The case was removed, and the government substituted, under the provisions of Section 2679(d) of Title 28.

The government's motion is based on the

theory that Section 2679(b) of the statute makes the remedy against the United States the exclusive remedy; that there are no rights against anyone else; that the plaintiff has been paid compensation under the Federal Employees' Compensation Act, 5 U.S.C.A., Section 757, which in Section 757(b) provides that government employees eligible for compensation may not sue their employer, the United States.

This case has been before other courts. In Beechwood v. United States, 264 F.Supp. 926, a decision of the District Court in Montana, on almost exactly the same facts, the court said:

> "The plaintiff's remedy against the United States is limited to recovery under the Federal Employees' Compensation Act and the United States' motion for summary judgment should therefore be granted. The case is dismissed and not remanded because plaintiff has no remedy against Selma Heathrel." Citing the statute. And paraphrasing: The act "insulates a federal employee from liability for injuries to another arising out of motor vehicle accidents happening in the course of federal employment."

The government has called to the Court's

attention a decision in the Northern District of California in 1967, not yet reported: Noga v. United States. A copy of the opinion is attached to the government's brief. And quoting from the opinion:

> Plaintiff "argues as follows: * * * To preclude plaintiff from a remedy after the passage of the Federal Drivers Act would be to impute to Congressional action an intent, admittedly absent, to cut off completely the remedy he previously had because he is fortuitously injured in a motor vehicle accident.
>
> "The Court does not agree with plaintiff's argument. What Congress would or would not have done if it had considered a particular problem is a profitless line of inquiry when general statutes can be found which set forth the law clearly. Section 2679(b) of 28 U.S.C. provides that the exclusive remedy of a person injured by the government employee driver of a motor vehicle is against the United States. This statute eliminates plaintiff's remedy against the driver, individually, which he had before 1961." Citing the Workmen's Comp. Act: "...provides that the exclusive remedy against the United States for an employee for injuries sustained in the course of his

employment is under the Federal Employee's Compensation Act. This statute precludes an employee from suing the United States under the Federal Tort Claims Act for injuries sustained while in the scope of his employment. Together these two statutes provide that plaintiff in the instant case has no cause of action against the United States other than under the Federal Employees' Compensation Act."

And it should be pointed out that the plaintiff in this case does not claim any cause of action against the Government of the United States. The plaintiff concedes that he has no cause of action against the United States, but claims that he should be permitted to pursue his common law remedies against Dorr Cameron, who was the defendant in the state court action, and calls attention to the opinion of Judge Mac Swinford, of the Eastern District of Kentucky, in Gilliam v. United States, 264 F. Supp. 7.

Judge Swinford reached the conclusion, in the reported case as well as in an earlier unreported decision, that if Congress had intended to abolish the right to sue, it would have expressly indicated so, meaning the right to sue the individual doing the injury.

We must respectfully disagree with Judge Swinford.

In the legislative history relating to this statute, and from the language of the statute, itself, it appears obvious that the intent of The Congress was to insulate government employees from suit where they might otherwise be liable in a common law action for negligence if such negligence was in the course of driving an automobile in the scope of their employment by the United States.

The government has not passed any other statute which has been called to this Court's attention which would insulate a government employee from suit for his negligent acts. The government has very definitely excluded suits by any person under the provisions of Section 2679(b) of Title 28, under the circumstances set forth in that section.

The sole cause of action where a driver driving in the scope of his employment as a government employee injures another person is by suit against the United States. As conceded by the plaintiff here, he cannot maintain a suit against the United States.

This Court is satisfied that, as pointed out by the California decision, indulging in speculation as to what The Congress would or would not have done if it had considered a specific problem which is now before the Court

is a profitless line of inquiry. Congressional attitudes are not that predictable.

The purpose of The Congress was very clear, and is still clear. The purpose of The Congress in enactin the statute as it did in 1961 was to prevent suits against drivers of government vehicles, or vehicles operated for th government, when the employee was operating within the cour of his employment.

In Judge Mac Swinford's opinion, he cites with approval and, in fact, may rely upon Marion v. United States, 214 F.Supp. 320.

As pointed out by counsel in this case, the Marion case has been cited as authority for a contrary resu than that reached in California and Montana, in the Noga ca in California and the Beechwood case in Montana.

However, an examination of the Marion case makes it obvious that the point which is now before the Court was not before the Court in the District Court for Maryland in the Marion case.

In that case, the accident in question occurred on August 27, 1959. On August 25, 1961, plaintiff instituted a suit under the Federal Tort Claims Act. The injured person was a Federal employee; the driver of the

ehicle inflicting the injury was driving a privately-owned ehicle, but driving in the course of his employment as a overnment employee. The Court granted summary judgment as o the United States, and let the suit stand as to the co-mployee defendant.

In reality, the Marion case is of no authority r consequence in the consideration of the rights of the arties here, since it appears that Section 2679(b), making he suit against the government the exclusive remedy, was mbodied in Public Law 87-258 of the Public Laws enacted in 961, and it was provided, in Section 2 of the act, without eading in detail:

> "The amendments made by this act," which includes Section (b), "shall be deemed to be in effect six months after September 21, 1961, but any rights or liabilities then existing shall not be affected."

In the Marion case, the claim came into xistence in 1959; suit was instituted before the effective ate of the statute. So while the motion was decided after he effective date, it doesn't make any difference.

So the government's motion for summary judgment is granted for the reasons herein stated.

And you may present an appropriate order,

Mr. Eardley.

MR. EARDLEY: Thank you, Your Honor.

THE COURT: All right.

MR. BROCK: One further thing, Your Honor.

If we submit a motion to remand, could we submit that along with the order denying the motion to remand all at the same time, and not have further oral arguments and briefs?

THE COURT: Certainly. I don't know any reason why not.

MR. BROCK: That would just keep the record straight.

THE COURT: Yes. That is not the reason for the Court's decision, although it might be a meritorious reason. That is not the reason for it. I would rather decide it on what I consider to be the merits of the controversy rather than the technical question.

MR. BROCK: I understand that, Your Honor.

THE COURT: So you are at perfect liberty to include in the file, before the order is prepared, a motion to remand, and include in the order, or Mr. Eardley can include in the order, a denial of the motion to remand.

MR. BROCK: Fine. Thank you, Your Honor.

THE COURT: All right. We will recess.

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IN THE UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF MICHIGAN

SOUTHERN DIVISION

I, Antoinette Duda, Official Court Reporter, do hereby certify that the foregoing is a full, true and correct transcript of the opinion of the court in this matter, according to my original stenographic notes.

Official Court Reporter
United States District Court
Western District of Michigan

No. A 22358

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

RONALD LEE MEYER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From The United States District Court
For The State Of Oregon

APPELLANT'S OPENING BRIEF

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By: Darrell E. Moore
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Attorneys for Appellant

No. A 22358

IN THE

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No. A 22358

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

RONALD LEE MEYER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF

QUESTION PRESENTED

Was the appellant, RONALD LEE MEYER, fairly and justly convicted of violating the "Dyer act" in the District Court for the State of Oregon?

SUMMARY OF CASE

The appellant, along with the co-defendant, Donald Edward Campbell, was charged in the trial court with a three

count indictment alleging the receiving, concealing, and selling certain motor vehicles which were moving in interstate commerce and which the defendants allegedly knew to have been stolen in violation of Title 18, section 23.13 United States Code.

The facts show that the indictment was returned by the grand jury on April 7, 1967.

The Government adopted the position that the defendants were involved in a "salvage operation" simply defined as the defendants purchasing salvage vehicles, thereafter removing the serial tags and license plates which constituted the title identity of the vehicles and thereafter placing said license plates and serial tags on other vehicles, which had been allegedly stolen, thereby altering the true title of the stolen vehicles which were allegedly sold by the defendants.

The Government intended as stated by the Government in a trial memorandum submitted to the trial court to establish their case by the testimony of various witnesses, by the introduction of records of used car dealers through the Business Records Act, and by the testimony of an F.B.I. agent, Max E. Taylor.

Additionally, the Government intended, and was successful in bringing before the jury, certain materials including a pop rivet gun and other items, said materials having been removed from the automobile owned by appellant Meyer.

The Government contended further that the initial arrest of Meyer on February 13, 1967, was lawful in that the arresting

warrant had been issued out prior to the arrest. In the Government's trial memorandum, they support this contention because the arrest warrant issued following the filing of a complaint. Thereafter, the Government proposed that the search of the vehicle producing the pop rivet gun and other materials was lawful as a normal incident of the arrest of the appellant.

Other matters were included in the Government's trial memorandum which are not considered relevant for the purpose of this appeal.

A review of the transcript of the proceedings before the United States District Court for the State of Oregon reveals the following factual portions and will hereafter be referred to as "TP."

ARGUMENT

It is appellant's intention to cite for the benefit of this Honorable Court, extracts from the transcript of proceedings to establish that error was committed in the trial court and that said error prejudiced the appellant thereby denying him the right to a fair trial and influencing the jury in their arrival at his determination of guilt.

First of all, the F.B.I. agent was allowed to sit at counsel's table throughout the proceedings, over the objection

of appellant's trial counsel, (page 10 TP), thereby lending undue influence upon the jury and identifying the chief witness against the parties as more than a mere witness and lending dignity to his ultimate testimony inconsistent with defendants' right to impartiality.

Prior to the commencement of the trial before the jury, there were certain agreements made regarding evidence to be admitted under the Business Records Act, said conversation between the Court and trial counsel occuring between pages 3 and 7 of the transcript of the court proceedings.

The trial judge made the observations on page 4, lines 13, 14 and 15 (TP) that he would not pass on admissibility of the records to be introduced. However, on page 17, it is reflected that when counsel for appellant made an inquiry concerning admissibility, the judge answered, "I am completely shocked,", and made statements (page 17 TP) which were obviously prejudicial to defendant in that his trial counsel was lectured and chided for raising the objection, the trial judge contending that all problems of admissibility had been determined, which is simply not the state of the record.

In all events the records were admitted, although the record is replete with the fact that at no time was there established the necessary qualifications to admit said records, namely that they were not exceptions to business practice, nor the producing of parties to testify as to chain of custody of said

records and proper parties to testify as to their capacity in maintaining and processing said records.

Commencing at page 49 (TP) testimony was given as to the witnesses having been shown photographs of various persons for the purpose of identification of the defendants, and admittedly the photographs were between five and seven in number and admittedly all photographs were not similar to the defendant or appellant, but in contrast, photographs were shown of parties who looked nothing like the appellant, leading the witnesses to identify the appellant as the party who had purchased vehicles and allegedly removed title thereto, all of which was again leading and suggestive by the investigating agent of the F.B.I. and prejudiced the appellant. A witness was produced by the Government, namely, Harry French, a detective with the Seattle Police Department who on page 92 (TP) testified that the photographs were not similar to the appellant although he showed them all on several occasions to the witnesses and this unfair use of dissimilar and repeated showing of the photographs to the witnesses, influenced the witnesses improperly in their ultimate identification of the appellant as shown by hesitation in identification by the witnesses on page 94 (TP).

Commencing at page 119 (TP), there is testimony by Martin Wright, a witness for the Government as to statements made by defendant Campbell which did lead the jury to believe

that a conspiracy existed for purposes of sale of stolen vehicles, all to the great prejudice of the appellant inasmuch as the evidence was heard by the jury with respect to the appellant and the testimony was not confined to defendant Campbell, but allowed in for all purposes.

On page 173 of the transcript, there commences testimony by Frank Perry, a member of the Washington State Patrol who testified as to the original arrest of the appellant on February 13, 1967. His testimony at page 174 indicates that the appellant had heretofore been arrested by two troopers of the same agency, although no probable cause was provided nor any justification for the arrest. The two troopers were not called as witnesses and as far as appellant is informed, he at that time, understood that no arrest warrant was in existence. The Government in its trial memorandum justified this arrest by saying that the arresting officers were informed that a lawful warrant for arrest had been issued and the Government propounded that it was lawful because the warrant issued following the filing of an attached complaint, whereas this case was presented by grand jury indictment and a true bill was not returned until April 7, 1967, some two months after appellant's original arrest. This is critical because certain items were then removed from appellant's car on the following day of his arrest, namely, February 14, 1967, and were utilized in the trial to a great extent, to-wit: testimony with

reference to said items by various witnesses, the fact that said items rested on the counsel table throughout the trial and were constantly referred to. These items were materials allegedly used to remove serial tags from salvage vehicles and although the court ultimately ruled out the admissibility of these items, the harm had befallen, at least with respect of influencing the minds of the jurors to the prejudice of the appellant.

The Court, in fact, sustained an objection (page 220 TP), to the search of the vehicle because the Government did not establish that from the time of the appellant's initial arrest on February 13, 1967, and the search of the vehicle on the following day, that the vehicle was not inaccessible, but again the sustaining of that objection after the trial had proceeded nearly to the conclusion of the Government's case had no meaningful effect in erasing from the minds of the jury, the prejudicial impact of the paraphernalia. Later, at page 246 of said transcript, the Court reversed, believing that proper inaccessibility had been established, and let the property into evidence.

Still further problems were raised regarding the items received from the search of appellant's car in that the F.B.I. agent sent those items to Washington, D.C. for apparent examination, but no chain of custody was established which the trial court recognized by its comment on page 74, lines 20 through 25 of said transcript. In the indictment sought by the Government, it was charged that the defendants knew that the

vehicles ultimately sold by them were stolen. However, the trial court refused to give a requested instruction sought by counsel for appellant, said instruction being as follows:

> "If you find that the defendant RONALD LEE MEYER was participating as a partner, or was otherwise associated in a business venture with defendant DONALD EDWARD CAMPBELL, and as a result of this arrangement believed that the defendant DONALD EDWARD CAMPBELL had lawfully acquired the motor vehicles in question and had a right to sell and dispose of such motor vehicles, then the defendant RONALD LEE MEYER would have no knowledge of the stolen character of these motor vehicles, and it would be your duty to return a verdict of 'not guilty' as to RONALD LEE MEYER."

The refusal to give said instruction was tantamount to the Court saying to the jury that we presume the vehicles were stolen, whereas the knowledge of defendants regarding said theft was critical to the establishment of the Government's case and clearly prejudicial to the appellant.

Counsel for appellant also took exception to an instruction read to the jury by the trial court, the effect of said instruction being that the defendants presumably knew of the theft of said vehicles and reading the two instructions together,

namely, the one given by the court and the one refused by the Court could clearly establish that the jury was not instructed to make an actual finding as to knowledge of theft.

This argument presented by counsel at the trial court is recited at page 430 and 431 of the transcript of the court proceedings.

CONCLUSION

As can clearly be seen by the argument presented, the appellant was not granted a fair trial for the following reasons:

1. Improper conduct of the trial judge
2. Denial of due process
3. Improper authentication and qualification of business records
4. Testimony of uncorroborated admissions by co-defendant
5. Illegal search and seizure
6. Unlawful arrest.

WHEREFORE, appellant prays this Honorable Court render its decision reversing the determination of guilty and remanding this matter for further proceedings in the trial court.

Dated: May15, 1968

Respectfully submitted,

BECKER & MOORE

By: Darrell E. Moore

Attorneys for Appellant

CERTIFICATE

I certify, that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Darrell E. Moore

DARRELL E. MOORE

No. 22358

United States
Court of Appeals
for the Ninth Circuit

RONALD LEE MEYER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Upon Appeal from the Judgment of the United States District Court for the District of Oregon

BRIEF OF APPELLEE

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GANN PUBLISHING CO., PORTLAND, OREGON 8-23-68

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Rule 30, *Federal Rules of Criminal Procedure - Instructions*

At the close of the evidence or at such earlier time during the trial as the court reasonably directs, any party may file written requests that the court instruct the jury on the law as set forth in the requests. At the same time copies of such requests shall be furnished to adverse parties. The court shall inform counsel of its proposed action upon the requests prior to their arguments to the jury, but the court shall instruct the jury after the arguments are completed. No party may assign as error any portion of the charge or omission therefrom unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury and, on request of any party, out of the presence of the jury.

Rule 52, *Federal Rules of Criminal Procedure - Harmless Error and Plain Error*

(a) *Harmless Error.* Any error, defect, irregularity or variance which does not affect substantial rights shall be disregarded.

(b) *Plain Error.* Plain errors or defects affecting substantial rights may be noticed although they were not brought to the attention of the court.

Rule 28(a), *Federal Rules of Appellate Procedure - Briefs*

(a) *Brief of the Appellant.* The brief of the appellant shall contain under appropriate headings and in the order here indicated:

(1) A table of contents, with page references, and a table of cases (alphabetically arranged), statutes and other authorities cited, with references to the pages of the brief where they are cited.

(2) A statement of the issues presented for review.

(3) A statement of the case. The statement shall first indicate briefly the nature of the case, the course of proceedings, and its disposition in the court below. There shall follow a statement of the facts relevant to the issues presented for review, with appropriate references to the record (see subdivision (e)).

(4) An argument. The argument may be preceded by a summary. The argument shall contain the contentions of the appellant with respect to the issues

presented, and the reasons therefor, with citations to the authorities, statutes and parts of the record relied on.

(5) A short conclusion stating the precise relief sought.

Rule 5, *Rules of the United States Court of Appeals for the Ninth Circuit - Practice*

The Federal Rules of Civil Procedure and the Federal Rules of Criminal Procedure, whenever relevant, are adopted as part of the rules of this court. In cases where the Federal Rules of Appellate Procedure and the Rules of the United States Court of Appeals for the Ninth Circuit are silent as to a particular matter of appellate practice, any relevant rule of the Supreme Court of the United States shall be applied.

Rules 40 1, (b), (c), (d), (e), *Revised Rules for the Supreme Court of the United States*

1. Briefs of an appellant or petitioner on the merits shall be printed as prescribed in Rule 39, and shall contain in the order here indicated—

* * *

(b) A concise statement of the grounds on which the jurisdiction of this court is invoked, with citation to the statutory provision and to the time factors upon which such jurisdiction rests.

(c) The constitutional provisions, treaties, statutes, ordinances and regulations which the case involves, setting them out verbatim, and citing the volume and page where they may be found in the official edition. If the provisions involved are lengthy, their citation alone will suffice at this point, and their pertinent text shall be set forth in an appendix.

(d)(1) The questions presented for review, expressed in the terms and circumstances of the case but without unnecessary detail. The statement of a question presented will be deemed to include every subsidiary question fairly comprised therein.

(2) The phrasing of the questions presented need not be identical with that set forth in the jurisdictional statement or the petition for certiorari, but the brief may not raise additional questions or change the substance of the questions already presented in those documents. Questions not presented according to this paragraph will be disregarded, save as the court, at its option, may notice a plain error not presented.

(e) A concise statement of the case containing all that is material to the consideration of the questions presented, with appropriate references to the appendix, e.g., (A. 12) or to the record, e.g., (R. 12).

No. 22358

United States
Court of Appeals
for the Ninth Circuit

RONALD LEE MEYER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Upon Appeal from the Judgment of the United States District Court for the District of Oregon

BRIEF OF APPELLEE

COUNTER-STATEMENT OF THE CASE[1][2]

On April 7, 1967, the Grand Jury returned a three (3) count indictment jointly charging the defendant Ronald Lee Meyer and one Donald Edward Camp-

[1] As used hereafter "TR" denotes transcript of proceedings, "Govt. Ex." Government's exhibits at trial, "D. Br." defendant's brief on appeal, and "Govt. App." Government's Appendix.

[2] Appellant's references to the Government's trial memorandum can only be described as a *non sequitur* since this pleading was prepared at the instance of the trial court to determine, if possible, the nature of the Government's evidence as well as any

bell[3] with receiving, concealing and selling certain motor vehicles which were moving in interstate commerce and which the defendants knew to have been stolen in violation of Title 18, Section 2313, United States Code (Govt. App. 10-11).

The trial commenced on June 20, 1967 and concluded on June 22, 1967, at which time the jury returned a verdict of guilty as to both defendants on all three counts. Each defendant was committed to the custody of the Attorney General for a period of five (5) years on each count, said sentences to run concurrently, and a ninety (90) day study ordered pursuant to provisions of Title 18, Section 4208(c) and 4208(b), United States Code. After initially electing to submit to the study, defendant Meyer posted bond and prosecuted his appeal.

The undisputed evidence admitted during the trial showed that in January 1967 the defendants purchased three (3) late model cars in salvage condition. The serial or warranty tags along with the li-

legal issues which might arise during trial. So far as the jury was concerned, the memorandum was never a matter of record nor was there ever any reference to it at any stage of the trial. Since this document was filed solely for the convenience of the trial court and not in response to any motions for a bill of particulars or discovery, the Government does not consider itself bound by or limited to any statements appearing therein.

[3] Following his conviction, defendant Campbell filed notice of appeal but to date has not perfected same.

cense plates from these vehicles were removed and affixed to cars of a similar description stolen in the State of Washington and later sold to dealers in Portland, Oregon, using the certificates of title from the salvage items as evidence of ownership.

On January 17, 1967, a poppy red 1965 two-door Mustang hardtop, owned by Compact City in Seattle, Washington, and being repaired by Commet Auto Rebuild, was stolen by a person or persons unknown (TR. 19-20, 26-27; Govt. Ex. 21, 41, 44).

On January 18, 1968, Meyer and Campbell appeared at Lincoln Auto Wreckers in Seattle, Washington (TR. 30-31, 65-67, 283, 345). Campbell, who represented himself as Ron Meyers, an out-of-state dealer, purchased a yellow 1965 Mustang without motor and transmission for $500.00 in cash (TR. 30-36; Govt. Ex. 16, 17, 18, 19, 40). Campbell received title to the vehicle while Meyer removed the license plates and warranty or serial tag from the left front door and placed them in back of his 1963 Cadillac (TR. 35-36, 67-68, 69, 283-284, 290-291; Govt. Ex. 40). The Mustang was never removed from its place of purchase although Meyer returned briefly a week later and inquired of its whereabouts (TR. 68-71, 309-310).

At approximately 6:00 P.M. on January 19, 1967, the 1965 poppy red Mustang stolen two days before

from Commet Auto Rebuild and bearing the serial tag, license plates and title of the salvage vehicle from Lincoln Auto Wreckers was sold to Mr. Samuel Neighbors of Joe Hoag Motors, Portland, Oregon, by defendant Meyer (TR. 97-101, 286-287; Govt. Ex. 14, 15, 40). In payment for this vehicle, Meyer received and subsequently negotiated a $1,400.00 check (TR. 100-101, 286-287; Govt. Ex. 15). The proceeds of the check were thereafter divided between the two defendants, with Meyer claiming Campbell received the bulk of the money (TR. 286-288). Campbell, however, contended Meyer retained the entire amount (TR. 360-361).

An examination of this vehicle at the Portland Police Garage by Special Agents Max Taylor and Howard Earp of the Federal Bureau of Investigation disclosed the warranty tag or plate appearing on the left front door was attached with a bolt or screw commonly known as a molly screw rather than with a hollow-head or exploding rivet traditionally used on Ford automotive products. (TR. 180-181). In the area under the hood where the public vehicle identification number[4] is located, there appeared to be a complete absence of any num-

[4] Since 1955 on Ford automotive products the vehicle identification and serial number have been synonymous and are used interchangeably. This number is located under the hood and on the warranty plate or serial tag attached to the left front door (TR. 176-180).

ber. However, approximately eight (8) inches to the rear of this area appeared a number which corresponded with the number on the warranty tag with the exception that the next to last digit was missing. An examination of the secondary vehicle identification number[5] disclosed it differed from the numbers appearing under the hood on the left front fender apron and on the warranty tag (TR. 180-181). The use of paint remover on the area where the public vehicle identification should have appeared revealed the presence of pounding and grinding (TR. 182; Govt. Ex. 21-23, 25-28). A comparison between a 3 by 5 inch index card containing a fingerprint and scotch tape "lift" of the secondary vehicle identification number from this vehicle with the dealer's records from Compact City, Seattle, Washington, for the 1965 Mustang stolen January 17, 1967 are conclusive of the theft (TR. 181, 183-184; Govt. Ex. 27, 41).

The succeeding day, January 20, 1967, the defendants presented themselves at Auto Salvage in Portland and inquired about two pieces of salvage: a 1964 Ford Galaxie and a 1965 Mustang (TR. 110-

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[5] In 1965 Mustangs, the public serial or vehicle identification number is located on the top flange on the left front fender apron, approximately 12-14 inches from the front of the car. The number is also placed in secondary locations known only to the manufacturer, Federal Bureau of Investigation, and the National Automobile Theft Bureau (TR. 177-180).

112). The negotiations culminated with Campbell purchasing the above vehicles, minus motors and transmissions for $750.00 cash (TR. 112, 113; Govt. Ex. 9, 10, 12, 30, 31). The titles to the cars along with the receipt for the sale were given to Campbell although the later document bore the name of Ron Meyer (TR. 114-116; Govt. Ex. 2, 13, 43).

Sometime between the sale[6] and the following Monday, Meyer removed the license plates and warranty or serial tags from the cars and again placed them in the rear of his 1963 Cadillac (TR. 118, 137, 289-290).

Although the defendants removed the 1964 Ford Galaxie, they never returned to claim the Mustang (TR. 120).

On January 22, 1967, two days after their transaction with Auto Salvage in Portland, a 1964 Ford Galaxie XL, two-door hardtop, was stolen from Dewey Griffins Used Car Lot in Lynnwood, Washington, and a second 1965 Ford Mustang two-door hardtop was stolen from Austin Fraser Used Cars in Seattle, Washington, by a person or persons unknown (TR. 145-147; Govt. Ex. 45 and TR. 150-153; Govt. Ex. 42).

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[6] January 20, 1967 was a Friday.

The following day, January 23, 1967, defendant Meyer reappeared at Joe Hoag Motors in Portland where he sold a 1964 Ford XL to Mr. Samuel Neighbors for $1,000.00 (TR. 102-106; Govt. Ex. 1, 3). At the time of the sale, this car bore the warranty tag, license plates and accompanying title of of the Ford Galaxie purchased from Auto Salvage only three days earlier (TR. 189-192; Govt. Ex. 2, 3, 5, 6, 7; see also TR. 116-117 and Govt. Ex. 12 which is the inventory record of Auto Salvage containing the license and serial numbers of the 1964 Ford Galaxie at the time it was sold to the defendants).

A subsequent examination of this vehicle by Special Agent Taylor revealed the warranty plate was attached to the left front door with pop or cherry rivets rather than the hollow head rivet used by Ford, while the area where the vehicle identification number should have appeared had been torn off[7] (TR. 190-191; Govt. Ex. 4). The secondary vehicle identification number was also found to differ from those appearing on the warranty tag and title (TR. 190-192; compare also Govt. Ex. 2, the title, and Govt. Ex. 5, the actual warranty plate, with Govt. Ex. 8, a scotch tape and fingerprint powder

[7] On a 1964 Ford Galaxie the serial or vehicle identification number appears under the hood on an extension on the right-hand side of the cowl (TR. 178).

"lift" of the secondary number). A comparison between the secondary number and the records from Dewey Griffins Used Car Lot in Lynnwood, Washington, for the 1964 Ford Galaxie stolen January 17, 1967, establish the theft of the vehicle (Govt. Ex. 8 and 45).

Approximately noon on this same date both defendants appeared at Jack's Eastport Motors in Portland and attempted without success to sell the 1964 Ford XL two-door hardtop (TR. 156-158). They left with this car after noting they also had a 1965 Mustang for sale. Both defendants returned on the same afternoon with a turquoise 1965 Mustang which they sold for $1,350.00 (TR. 158-161). The title to the vehicle was produced by Campbell while the check for its payment was drawn in the name of Ron Meyer at Campbell's instance (TR. 159, 161, 168-169; Govt. Ex. 29, 43). Prior to consummating the transaction, the purchaser checked the title proffered by Campbell against license plates and warranty tag on the car and found they were in consonance (TR. 160, 167-168). No examination was made under the hood of the car (TR. 160).

In addition to the title, the warranty tag and the license plates on this vehicle were identical to those previously removed by Meyer from the 1965 Mustang salvage item purchased from Auto Salvage on

January 20, 1967 (Compare TR. 195-199 and Govt. Ex. 33, 34, 36 with TR. 116-117, 137-138 and Govt. Ex. 30, 31, 32, 43). The car's public vehicle identification number had also been pounded out, ground down, and painted over, and a new number inserted which corresponded with the documents of title (TR. 195-199, and compare Govt. Ex. 35, a picture of the fictitious vehicle identification number with Govt. Ex. 36 and 43 which are the warranty tag and the title, respectively). As in the case of the other stolen vehicles, the warranty tag was attached to the left front door with pop-type rivets while the secondary number failed to correspond with the numbers on the warranty tag or title (TR. 196; Govt. Ex. 36, 37, 37-A, 43). A comparison of the fingerprint and scotch tape "lift" of the secondary number with the records of Austin-Fraser in Seattle for the 1965 Mustang stolen on January 22, 1967, established the theft of this vehicle (TR. 196-197, 199; Govt. Ex. 37, 37-A, 42).

On February 3, 1967, the defendants again returned to Auto Salvage in Portland at which time Campbell informed the general manager Marvin Wright he would pay $300.00 for each set of license plates, warranty tags and titles Wright could supply (TR. 110-111, 116-119).

On the morning of February 8, 1967, the defendants reappeared and Campbell inquired whether

there were any titles or plates available. Plans were then made to meet the same evening for a drink (TR. 121).

As Mr. Wright left his house on the evening of the 8th, he was forced to the curb by a 1963 Cadillac driven by Meyer and accompanied by Campbell (TR. 122). At the request of Campbell, Mr. Wright entered the front seat of this vehicle flanked on either side by the defendants (TR. 122-123).

Campbell inquired whether the Federal Bureau of Investigation had appeared at Auto Salvage. Following Wright's denial, Meyer stated they had nothing "to worry about . . . anyway" (TR. 125). The parties then proceeded to the North Dakota Inn where Campbell asked whether Wright had "wrecked" the 1965 Mustang and if he would take a "torch" to the serial number on this vehicle (TR. 126). Campbell further informed Wright that if he ever wanted to leave the wrecking business and make "big money" to let him (Campbell) know (TR. 126).

In testifying in their own behalf, each of the defendants admitted the transportation of the three (3) vehicles described in the indictment from the State of Washington to Portland, Oregon, but denied any knowledge of their stolen character (TR. 277-301, 340-370).

On February 6, 1967, a complaint was filed before United States Commissioner Louis Stern in Portland, Oregon, charging the defendant Meyer with receiving, concealing and selling the 1964 Ford stolen from Dewey Griffins Used Car Lot in Lynnwood, Washington, in violation of Title 18, Section 2313, United States Code (Govt. App. 1-2). A warrant was issued, and on February 13, 1967, Meyer was arrested in Woodland, Washington while driving his 1963 Cadillac by officers of the Washington State Patrol (TR. 173-174).

At the scene of the arrest, Sgt. Frank Perry examined the car including the front and rear seats, trunk and glove compartments. The car was then driven to Don's Texaco Service Station in Woodland, Washington, where it was impounded and the contents inventoried (TR. 174-175, 205-207). It was then stored at the residence of Mr. Don Stevenson, owner of the station and an agent bonded by the State of Washington for the purpose of storing impounded vehicles (TR. 205-207).

Both Sgt. Perry and Mr. Stevenson testified nothing was removed from the vehicle (TR. 175, 206-207).

On February 14, 1967, William Church, United States Commissioner for the Western District of

Washington, issued a search warrant for defendant's vehicle (Govt. App. 5-8). The warrant was executed the same day and the vehicle searched by Agents Taylor and Netter of the Federal Bureau of Investigation. A pop-rivet gun, its container, and certain metal die stamps were removed from the trunk (TR. 207-209, 219-220, 245-248, 262-263; Govt. Ex. 38, 38-A, 39, 39-A).

The pop-rivet gun was subsequently identified as the same as or similar to the tool which installed the warranty plates on the 1964 Ford stolen from Dewey Griffins Used Car Lot and the 1965 Mustang stolen from Austin Fraser Motors (TR. 266-269; Govt. Ex. 5, 36, 38, 38-A).

The die stamps removed from the trunk of defendant's car were stricken from the record on the theory the Government violated the best evidence rule by failing to produce the container in which they were transmitted to and from Washington, D.C. (TR. 273-276, 410-411; Govt. Ex. 39, 39-A).

SUMMARY OF ARGUMENT

I.

The ruling of Trial Court permitting F.B.I. Agent Max Taylor to remain at Government counsel table during the trial and to eventually testify was not error being within the sound discretion of the Court which will not be reviewed absent a case of clear abuse.

II.

The comments of the Trial Court, selected out of context, with respect to a certain record offered under the Business Records Act were not error and in no way militated against defendant's right to a fair trial. Moreover the failure of either trial counsel to assert this point in Court below constituted a waiver thereby precluding its review.

III.

Defendant's contention that records admitted under the Business Records Act lacked the requisite foundation is totally without merit. This point was again waived by the failure of either trial counsel to object to any Government exhibit save two (2), neither of which were business records, and both of which were eventually stricken from the record.

IV.

The showing of photographs by police officers and F.B.I. Agents to a prospective Government witness in an attempt to determine the identity of the defendants was neither prejudicial nor improperly suggestive. This point must also be considered to have waived since neither trial counsel interposed any objection or sought any other remedial action.

V.

The statements of the defendant Campbell made to a third person during the course of the illegal venture were properly admitted against the defendant Meyer.

VI.

There was no impropriety in the arrest of the defendant Meyer or in the subsequent search of his vehicle. These events were predicated upon the filing of a complaint and the issuance of a search warrant which are clearly sufficient under applicable legal principles and which were never questioned by either trial counsel.

VII.

The Trial Court's refusal to give defendant's requested instruction on the issue of guilty knowledge was not error, a similar and more favorable instruction on the same issue having been given.

ARGUMENT

I.

The Ruling of the Trial Court Permitting FBI Agent Max Taylor to Remain at Government Counsel Table Throughout the Trial was not Error Being within the Sound Discretion of the Court.

Defendant contends error was committed in permitting FBI Agent Taylor to remain at Government counsel table during the course of trial (D. Br. 3-4). It is well settled that authorizing a Government agent to remain in the courtroom to assist and advise Government counsel during trial rests within the sound discretion of trial court which will not be reviewed absent a case of clear abuse. This rule obtains even though the agent testifies, as did Agent Taylor in the case at bar, after observing the demeanor and hearing the testimony of preceeding witnesses. *Powell v. U.S.*, 208 F.2d 618, 619 (6th Cir., 1953), *cert. den.* 347 U.S. 961; *Schoppel v. U.S.* 270 F.2d 413, 416-417 (4th Cir., 1959); *Portomene v. U.S.*, 221 F.2d 582 (5th Cir., 1955); *Laird v. U.S.*, 252 F2d 121 (4th Cir., 1958); *Johnston v. U.S.*, 260 F.2d 345, 347 (10th Cir., 1958), *cert. den.* 360 U.S. 935. See also *Dancy v. U.S.*, 390 F.2d 370, 371 N. 1 (5th Cir., 1968). It is clear therefore defendant's unspecified assignment of prejudice eminating from the Court's ruling is wholly without merit particularly since all other Government witnesses were excluded prior to the *voir dire* (TR. 11-12).

II.

The Trial Court's Comments With Respect To The Admissibility Of Documents Offered Under The Business Records Act In No Way Deprived Defendant Of A Fair Trial.

Defendant has selected out of context and alleged as prejudicial error a single statement by the trial court concerning the admission of a certain document offered under the Business Records Act (Title 28, Section 1732, United States Code) (D. Br. 4; TR. 17). Although the assignment might be summarily disposed of as *de minimus* in nature and clearly devoid of error, in view of the charge some comment seems appropriate.

When read in its proper context, it is patently apparent the statement complained of is but an expression of concern on the part of the trial court over an issue which supposedly had been litigated prior to trial (TR. 16-18). In what manner the statement or the "obviously prejudicial" remarks which allegedly followed but which are neither set forth in defendant's brief nor found in the record were improper is left completely to the imagination (D. Br. 4, TR. 17). That neither trial counsel considered his client's rights to have been impaired is manifest by their failure to take exception to the statement, move for a mistrial or request any cautionary

or protective instructions. The cases are legion that issues, even if constitutional, not properly raised and preserved in the trial court for review, will not be noticed on appeal. See for example *U.S. v. Millpax,* 313 F.2d 152, 156-157 (7th Cir., 1963), *cert. den.* 373 U.S. 903; *U.S. v. McCarthy,* 297 F.2d 183 184 (7th Cir., 1961), *cert. den.* 369 U.S. 850; *U.S. v. Greenberg,* 268 F.2d 120, 123-124 (2nd Cir.,1959); *Minor v. U.S.,* 375 F.2d 170, 172 (8th Cir., 1967), *cert. den.* 389 U.S., 882; *U.S.v.Miller,* 316 F.2d 81 (6th Cir., 1963), *cert. den.* 375 *U.S.* 935; and *Hansberry v. U.S.,* 295 F2d 800, 801 (9th Cir, 1961) The only exception to the foregoing proposition is where failure to consider the point on appeal would result in an obvious miscarriage of justice despite defendant's failure to raise the issue in the trial court (R. 52(b), Federal Rules of Criminal Procedure). Not only does the record in the instant case not warrant the invocation of the "plain error" doctrine, but defendant himself makes no such suggestion.

Defendant has also conveniently overlooked the trial court's caveat to the jury characterizing the discussion with counsel as simply a "misunderstanding" which they were to disregard (TR. 18, 23-24). Suffice to say the foregoing indicates not the slightest prejudice toward either the defendant or his trial counsel.

III.

No Error Was Committed In Admitting Records Proffered Under the Business Records Act.

Defendant contends "records" were admitted under the Business Records Act, Title 28, Section 1732, United States Code, without the requisite foundation (D. Br. 4). Exactly what "records" and in what particulars their foundation was deficient we are not told. The weakness inherent in defendant's contention is that once again he neatly overlooks the complete absence of any objection whatever by either trial counsel to any Government exhibits save the metal die stamps taken from the trunk of defendant Meyer's car following his arrest (Govt. Ex. 39, 39-A). These two (2) exhibits were eventually stricken from the record (TR. 411).

With respect to the question of waiver, see Government's Brief Point II and cases cited therein.

IV.

The Showing Of Photographs To Prospective Witnesses For Purposes Of Identification Was Neither Prejudical Nor Improperly Suggestive.

Without citation of authority it is contended the use of photographs shown to "various persons" in an attempt to identify the defendant was unneces-

sarily suggestive thereby requiring reversal (D. Br. 5). Aside from his reference to page 49 of the Trial Transcript which encompassed the cross examination of Mr. Edward Lincoln of Lincoln Auto Wreckers, Seattle, Washington, no names of, references to any other witnesses are made. The Government will therefore confine its remarks on this issue to Mr. Lincoln's testimony.

The fact that Mr. Lincoln was shown numerous photographs on several occasions is not indicative of any impropriety. A review of his testimony in its entirety clearly shows an attempt on the part of the Government to identify two (2) unknown subjects (TR. 29-60), a legitimate function of law enforcement officers. *Simmons v. U.S.*, 390 U.S. 377, 384 (1968). See also: *U.S. v. Marson* .... F2d .... (4th Cir 1968). This procedure is readily distinguishable from a case where the prosecution repeatedly displays to a prospective witness(es) photographs of a known subject thereby enhancing the prospects for courtroom identification.

Moreover, the procedure used by the police and Federal Bureau of Investigation in the case at bar was obviously considered not to have been " . . . so impermissibly suggestive as to give rise to a very substantial likelihood of irreparable misidentification" since neither trial counsel interposed any

objection, made motions to strike, for mistrial, or sought any other curative action. *Simmons v. U.S.*, 390 U.S. 377, 384 (1968), and Government's Brief Point II above and cases cited therein.

V.

The Statements Of The Defendant Campbell To A Third Person During The Course Of The Conspiracy Were Properly Admitted Against The Defendant Meyer.

It is urged that failure to restrict the admissibility of various incriminating statements made by defendant Campbell to Government witness Marvin Wright solely to the declarant Campbell was error (D. Br. 5-6; TR. 118-121, 125-127).

Initially it must be noted that not only did some of the conversations related by Mr. Wright take place in the presence of the defendant Meyer, but once again there were no objections or requests for limiting or cautionary instructions by either trial counsel (TR. 121-123, 125-127).

Turning to the merits of defendant's contention, it is well settled that declarations of one defendant implicating another or showing the latter's guilty knowledge may properly be considered by the jury in passing upon the guilt of each of the parties charged once the trial court is satisfied there is suf-

ficient evidence, if believed by the jury, independent of the statement(s), to establish the conspiracy or illegal venture. Such evidence is not inadmissible hearsay, falling " . . . within the well recognized exception to the . . . rule that one co-conspirator's statements are admissible against another." *White v. U.S.*, 394 F.2d 49, 54 (9th Cir., 1968). In addition, the trial court's charge to the jury on the matter set forth below was, in all probability, more favorable to the defendants than the law requires. *White v. U.S.*, 394 F.2d 49, 52 (9th Cir., 1968).

> "When two or more persons knowingly associate themselves together to carry out a common plan, either lawful or unlawful, there arises from the very act of knowingly associating themselves together, for such a purpose, a kind of partnership, in which each member becomes the agent of the other.
>
> "So, where the evidence in the case shows a common plan or arrangement between two or more persons, evidence as to an act done or statement made by one is admissible against all, provided that the act be knowingly done and the statement be knowingly made during the continuance of the arrangement between them, and in furtherance of some object or purpose of the common plan or arrangement, if any.
>
> "In order to establish proof that a common plan or arrangement, if any, existed, the evidence must show that the parties to the plan

in some way or manner, or through some contrivance, positively or tacitly came to a mutual understanding to try to accomplish some common object or purpose.

"In order to establish proof that a defendant was a party to or member of some common plan or arrangement, the evidence must show that the plan was knowingly formed, and that the defendant knowingly participated in the plan, with the intent to advance or further some object or purpose of the plan.

"In determining whether or not a defendant was a party to or a member of a common plan, you are not to consider what others may have said or done. That is to say, the membership of a defendant in a common plan must be established by evidence as to his own conduct — what he himself knowingly said or did.

"If and when it appears from the evidence in the case that a common plan did exist, and that a defendant was one of the members, then the acts thereafter knowingly done, and the statements thereafter knowingly made, by any person likewise found to be a member, may be considered by you as evidence in the case as to the defendant found to have been a member, even though the acts and statements may have occurred in the absence and without the knowledge of the other defendant, provided that such acts and statements were knowingly done and made during the continuance of the common plan, and in furtherance of some object or purpose of the plan.

> "I again repeat that otherwise, any admission or incriminatory statement made or any act done by one person, outside of court, may not be considered as evidence against any person who was not present and saw the act done or heard the statement made.
>
> "A statement or an act is 'knowingly' made or done if made or done voluntarily and intentionally, and not because of mistake or accident or other innocent reason." (TR. 420-422)

That defendants were not formally charged with conspiracy neither vitiates nor alters test for the admissibility of the declaration of one against another. *Hitchman Coal & Coke Co. v. Mitchell,* 245 U.S. 229, 249 (1917); *Fuentes v. U.S.,* 283 F.2d 537, 539 (9th Cir., 1960); *U.S. v. Olweiss,* 138 F.2d 798, 800 (2nd Cir., 1943), *cert den* 321 U.S., 744; *U.S. v. Smith,* 343 F.2d 847, 849 (6th Cir., 1965), *cert den.* 382 U.S. 824; *U.S. v. Jones,* 374 F.2d 414, 418 (2nd Cir., 1967), *cert den.* 389 U.S. 835.

VI.

There Was No Impropriety In Defendant's Arrest Or The Subsequent Search Of His Car.

In vague and nebulous terms defendant complains about the propriety of his arrest and the subsequent search of his car (D. Br. 6-7). However, at no time from the inception of the prosecution until the filing

of the notice of appeal did defendant see fit to urge, directly or indirectly, either of these points.

Turning to the merits of defendant's assignment notwithstanding its waiver the record reflects a complaint was filed in Portland, Oregon, on February 6, 1967 charging defendant Meyer with a violation of Title 18, Section 2313, United States Code (Govt. App. 2-3). A warrant was issued and seven (7) days later Meyer was arrested by officers of the Washington State Patrol (D. Br. 6; TR. 173-174).

The arrest is challenged in part upon the theory that at the time it was effected, defendant was personally unaware of the existence of any warrant (D. Br. 6). Unfortunately defendant offered no testimony on this question thereby precluding review of his unrecorded thoughts. It is well established on appeal that the evidence will be viewed not through the eyes of the defendant, but in the light most favorable to the Government. *Glasser v. U.S.*, 315 U.S. 60, 80 (1942); *White v. U.S.*, 394 F.2d 49, 51 (9th Cir., 1968).

In any event, the validity of the arrest is bottomed, not upon the defendant's state of mind, but upon the sufficiency of the complaint itself. *Giordenello v. U.S.*, 357 U.S. 480 (1958). In the case at bar the precepts set forth by the Supreme Court in

Giordenello are clearly satisfied by the complaint of February 6, 1967 (Govt. App. 2-3).

After the arrest, the car was searched, its contents examined, and later inventoried (TR. 173-175, 205-207). None of the contents, however, were removed until February 14, 1967, when a search warrant issued by the United States Commissioner for the Western District of Washington (Govt. App. 5-9) was executed by Agents of the Federal Bureau of Investigation. Pursuant to its authority, a pop-rivet gun, its container and certain metal die stamps were removed from the trunk of the car (TR. 207-209, 219-220, 245-248, 262-263; Govt. Ex. 38, 38-A, 39, 39-A).

Defendant's concern over the fact the search preceded the indictment's return by some two (2) months is without foundation (D. Br. 6; Govt. App. 10-11). The validity of the initial arrest on February 13, 1967 and the propriety of the search the following day rest entirely upon the sufficiency of the complaint, the search warrant, and the accompanying affidavit (Govt. App. 2-9). *Giordenello v. U.S.*, 357 U.S. 480 (1958); *Aguilar v. Texas,* 378 U.S. 108 (1964); *U.S. v. Ventresca,* 380 U.S. 102 (1965); Rule 41, Federal Rules of Criminal Procedure.

Even a cursory perusal of these documents demonstrates defendant's assignment is without basis in law or fact.

VII.

Trial Court's Refusal To Give Defendant's Requested Instruction On The Issue Of Guilty Knowledge Was Not Error, A Similar And More Favorable Instruction On The Same Issue Having Been Given.

It is suggested the trial court's refusal to give defendant's requested instruction on the issue of guilty knowledge was error (D. Br. 8). Defendant carefully ignores the inclusion in the court's charge of a more favorable instruction on this precise issue (TR. 419-420). This instruction and those immediately preceding it on the same and related issues provide:

> "Now, the essential elements required to be proved in order to establish the offense as charged in each count of the indictment are:
>
> "First, the act of receiving, concealing and selling a stolen motor vehicle which moved in interstate commerce, as charged;
>
> "Second, doing such act wilfully and with the knowledge that the motor vehicle described in each count of the indictment had been stolen and had moved in interstate commerce.

"The offense is complete when these elements just read are established by the evidence in the case. The Government need not show who may have stolen the motor vehicle.

"As previously mentioned, the burden of proof is always on the Government to prove beyond a reasonable doubt each essential element of the crime as to each count.

"As I have previously mentioned, one essential element of the offense as charged in each count is knowledge of the accused that the automobile was, in fact, a stolen automobile at the time the alleged offense was committed. If you should find that one of the defendants, in good faith, believed that the other defendant owned the automobile in question, or owned some interest therein, or that the other defendant had the right to possession of the motor vehicle at the time and place of the alleged events, then the defendant so believing cannot be found to have wilfully received, concealed and sold a stolen motor vehicle moving in interstate commerce, and it would be your duty to return a verdict of not guilty in his favor." (TR. 419-420)

The proposition that the trial court is not obliged to follow verbatim defendant's requested instructions so long as the charge adequately covers the law including defendant's theory is so well accepted no citation of authority is necessary.

Defendant also assigns as error the giving of an-

other but completely unspecified instruction (D. Br. 8-9). Interestingly enough, although defendant claims he excepted to this instruction (D. Br. 8), the record clearly manifests his sole exception was to the court's failure to give the instruction set forth on page 8 of his brief and discussed above (D. Br. 8; TR. 429-431). The only other exception to any portion of the charge was by counsel for defendant Campbell. Defendant Meyer cannot cure his failure to render timely objection by relying upon the objection interposed by his co-defendant; an objection in which he saw fit not to join (TR. 430-431). Rule 30, Federal Rules of Criminal Procedure.

It must be noted at this juncture that with the exception of his initial assignment, discussed in Point I of the Government's Brief, defendant's abject failure to specify the errors alleged and clearly articulate his contentions with respect to them in contravention of the rules for preparation of briefs on appeal[8] has rendered it particularly onerous for the Government to determine what issues are being raised and how to answer same. Although it has long been acknowledged that issues not properly presented for review will not be noticed, *U.S. v. Cushman,*

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[8] Rule 28, Federal Rules of Appellate Procedure; Rule 5, Rules of United States Court of Appeals for the Ninth Circuit; Rule 40, Revised Rules for the Supreme Court of the United States. See also former Rules 18 and 19 of Court of Appeals for the Ninth Circuit.

136 F.2d 815, 817 (9th Cir., 1943), *Neely v. Eby Const. Co.*, 386 U.S. 317, 330 (1967), rehearing *den.* 386 U.S. 1027, defendant is fain to rely upon the sagacity, clairvoyance, tenacity of the Government and presumably the Court to determine precisely what issues he wishes to litigate. Notwithstanding his failing in this respect, it is evdent from both the record and the briefs not only was no error committed in the Court below, but defendant received the benefit of an eminently fair trial.

CONCLUSION

WHEREFORE, on the basis of the above and foregoing, it is respectfully urged the judgment of conviction of the defendant Ronald Lee Meyer be affirmed.

Respectfully submitted,

SIDNEY I. LEZAK
United States Attorney
District of Oregon

CHARLES H. TURNER
Assistant United States Attorney

1

APPENDIX

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

UNITED STATES OF AMERICA,

v.

RONALD L. MEYER,
Defendant.

CR 67-117
Commissioner's Docket No.
CM 7-44
COMPLAINT for VIOLATION of U.S.C. Title 18 Section 2313

BEFORE LOUIS STERN, Portland Oregon,

The undersigned complainant being duly sworn states: That on or about January 23, 1967, at Portland in the District of Oregon RONALD L. MEYER, defendant did wilfully, knowingly, unlawfully and feloniously receive, conceal and sell a stolen motor vehicle, that is a 1964 Ford 2-door Sedan, Serial No. 4G68C123837, which was moving as interstate commerce from Lynnwood, Washington, to Portland within the District of Oregon, the said defendant then and there well knew the said motor vehicle to have been stolen; in violation of Section 2313, Title 18, United States Code.

And the complainant states that this complaint is based on the following: On or about 1-20-67, at Portland, Oregon, Meyer was present and participated in the purchase of a totally wrecked 1964 Ford 2-door hardtop sedan, Serial No. 4G66X158141, Oregon License BAL-450. Title to this vehicle was surrendered by the seller, and the vehicle was left on the premises of the seller. The license plates and

warranty plate bearing the Serial No. 4G66X158141 was removed from the vehicle on or about 1-23-67 at Portland, Oregon. Meyer sold a 1964 Ford 2-door hardtop bearing Oregon License BAL-450, and warranty plate bearing Serial No. 4G66X158141, and surrendered Oregon title bearing this license number and serial number. An examination of this vehicle at Portland, Oregon, on 1-30-67, reflected the true Serial No. to be 4G68C123837. It was determined that a 1964 Ford 2-door hardtop, Serial No. 4G68C123837, and Washington License JJT-464 had been reported as stolen from Lynnwood, Washington on or about 1-23-67. On 2-3-67, Meyer participated in the removal, from the premises of the seller at Portland, Oregon, the totally wrecked 1964 Ford 2-door hardtop sedan, Serial No. 4G66X158141.

/s/ Max E. Taylor

MAX E. TAYLOR

Special Agent - F.B.I.

Sworn to before me, and subscribed in my presence, February 6, 1967.

/s/ Louis Stern

LOUIS STERN

United States Commissioner

A TRUE COPY
Donal D. Sullivan, *Clerk*

(Seal)

By /s/ E. Nowell
Deputy Clerk

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT COURT
SOUTHERN DIVISION

Commissioner's Docket No. 1

UNITED STATES OF AMERICA, **Case No. 101**

v. **SEARCH WARRANT**

RONALD LEE MEYER

TO

Affidavit having been made before me by John Carl Netter that he has reason to believe that on the premises known as 1963 Cadillac 2-Door with Oregon License 5R7373 located at Woodland, Washington in the Western District of Washington there is now being concealed certain property, namely warranty plates, master ignition keys, metal stamping dies, a riveting gun, set of Washington automobile dealers plates and miscellaneous tools which are believed to have been used as instrumental in connection with the false documentation of stolen motor vehicles and as I am satisfied that there is probable cause to believe that the property so described is being concealed on the premises above described and that the foregoing grounds for application for issuance of the search warrant exist.

You are hereby commanded to search forthwith

the person/place named for the property specified, serving this warrant and making the search at any time in the day or night and if the property be found there to seize it, leaving a copy of this warrant and a receipt for the property taken, and prepare a written inventory of the property seized and return this warrant and bring the property before me within ten days of this date, as required by law.

Dated this 14 day of February, 1967.

/s/ William Church

U.S. Commissioner

A TRUE COPY
Donal D. Sullivan, Clerk

(Seal)

By /s/ M. Hartzell

Deputy Clerk

AFFIDAVIT FOR SEARCH WARRANT

UNITED STATES OF AMERICA)

WESTERN DISTRICT OF WASHINGTON)

SOUTHERN DIVISION)

JOHN CARL NETTER, being first duly sworn, under oath, deposes and says: That he is a Special Agent for the Federal Bureau of Investigation stationed at Vancouver, Washington, and that in the course of his official duties he has participated in an investigation of a series of activities including the theft and interstate transportation of stolen motor vehicles pursuant to a federal warrant issued by a U.S. Commissioner, Portland, Oregon on February 6, 1967, charging Ronald L. Meyer with violation of Title 18, Section 2313, U.S. Code. Meyer was arrested near Woodland, Washington on February 13, 1967 by officers of the Washington State Patrol. At the time of the arrest and incidental to the arrest the vehicle operated by Meyer, a 1963 Cadillac Two-Door, Oregon License 5R7373 was searched by officers of the Washington State Patrol and they observed the following items: In the glove compartment were ten (10) to twelve (12) keys which appeared to be master automobile ignition keys and two warranty

plates for Ford cars. Also observed in the trunk of this Cadillac, a set of Washington automobile dealers plates, a set of metal stamping dies, and a hand riveting gun and other miscellaneous tools. Ronald L. Meyer has been identified as selling a stolen 1964 Ford Two-Door sedan which was traveling in interstate commerce, on which a warranty plate had been attached by means of a rivet other than that used by the manufacturer. In addition, he has been identified as selling a stolen 1965 Mustang that was traveling in interstate commerce and on which the serial number had been obliterated and another number stamped with dies similar to those observed by officers of the Washington State Patrol. In addition the warranty plates observed did not belong to the 1963 Cadillac in which Meyer was arrested. In addition, the large number of ignition keys are believed to be the type which will unlock the ignition of most Ford automobiles.

That your affiant requests a search warrant for said 1963 Cadillac, particularly searching for warranty plates, master ignition keys, metal stamping dies, a riveting gun, a set of Washington automobile dealers plates and miscellaneous tools which were

in fact used in furtherance of false documentation of stolen vehicles.

/s/ John Carl Netter

Subscribed and sworn to before me this 14 day of February, 1967.

/s/ William Church

United States Commissioner
Western District of Washington

A TRUE COPY
Donal D. Sullivan, *Clerk*

(Seal)

By /s/ M. Hartzell
Deputy Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

UNITED STATES OF AMERICA,

vs.

RONALD LEE MEYER and
DONALD EDWARD CAMPBELL,

Defendants.

NO. CR 67-117
INDICTMENT
[18 U.S.C. § 2313]

THE GRAND JURY CHARGES:

COUNT I. That on or about January 23, 1967, at Portland, within the District of Oregon, RONALD LEE MEYER and DONALD EDWARD CAMPBELL, defendants, did wilfully, knowingly, unlawfully and feloniously receive, conceal and sell a stolen motor vehicle, that is a 1964 Ford 2-door Sedan, Serial No. 4G68C123837, which was moving as interstate commerce from Lynnwood, Washington, to Portland, within the District of Oregon. Defendants then and there well knew said motor vehicle to have been stolen; in violation of Section 2313, Title 18, United States Code.

COUNT II. That on or about January 19, 1967, at Portland, within the District of Oregon, RONALD LEE MEYER and DONALD EDWARD CAMPBELL, defendants, did wilfully, knowingly, unlawfully and feloniously receive, conceal and sell a stolen motor vehicle, that is a 1965 Mustang 2-door Hardtop, Serial No. 5F07D152305, which was mov-

ing as interstate commerce from Seattle, Washington, to Portland, within the District of Oregon. Defendants then and there well knew said motor vehicle to have been stolen; in violation of Section 2313, Title 18, United States Code.

COUNT III. That on or about January 23, 1967, at Portland, within the District of Oregon, RONALD LEE MEYER and DONALD EDWARD CAMPBELL, defendants, did wilfully, knowingly, unlawfully and feloniously receive, conceal and sell a stolen motor vehicle, that is a 1965 Mustang 2-door Hardtop, Serial No. 5F07D159898, which was moving as interstate commerce from Seattle, Washington, to Portland, within the District of Oregon. Defendants then and there well knew said motor vehicle to have been stolen; in violation of Section 2313, Title 18, United States Code.

Dated this 7th day of April, 1967.

A TRUE BILL.

/s/ L. F. Aichlmayr

Foreman

SIDNEY I. LEZAK
United States Attorney
District of Oregon

/s/ Charles H. Habernigg

CHARLES H. HABERNIGG
Assistant United States Attorney

NO. 22361

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HOLLOWAY HOUSE PUBLISHING CO.,
a California corporation,

Appellant,

vs.

WESLEY S. SHARP, individually, and as Chief of Police of the City of San Diego, and EDWARD T. BUTLER, Individually, and as City Attorney for the City of San Diego,

Appellees.

APPELLANT'S OPENING BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

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Attorneys for Appellant

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Attorneys for Appellant

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(Continued)

TABLE OF AUTHORITIES

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Appellees.

APPELLANT'S OPENING BRIEF

This is an appeal from a judgment rendered by the Honorable Fred Kunzel, a Judge of the United States District Court for the Southern District of California, denying appellant's motion for summary judgment, granting appellees' cross motion for summary judgment, and dismissing this action in favor of appellees and against appellant.

JURISDICTION

The jurisdiction of the District Court was based upon R. S. 1979, 42 U. S. C. 1983, 42 U. S. C. A. 1983 and 28 U. S. C. 1343(3),

28 U. S. C. A. 1343(3), the action being one to redress the deprivation under color of statute, ordinance, regulation, custom and usage of a right, privilege and immunity secured to appellant by the Fourteenth Amendment to the United States Constitution. The jurisdiction of the District Court was further invoked under R. S. 1979, 42 U. S. C. 1983, 42 U. S. C. A. 1983 and 28 U. S. C. 1331, 28 U. S. C. A. 1331, the action being one wherein the matter in controversy exceeds the sum and value of $10,000.00, exclusive of interest and costs, and arises under the Constitution and laws of the United States.

The jurisdiction of this Court to review the judgment in question is based upon 28 U. S. C. 1291, 28 U. S. C. A. 1291 and Rule 73 of the Federal Rules of Civil Procedure.

The pleadings and facts disclosing the basis of the aforesaid jurisdiction are as follows:

The complaint seeking declaratory and equitable relief under R. S. 1979, 42 U. S. C. 1983, 42 U. S. C. A. 1983, 28 U. S. C. 1343(3), 28 U. S. C. A. 1343(3) and 28 U. S. C. 1331, 28 U. S. C. A. 1331 to redress the deprivation of appellant's rights, privileges and immunities secured by the Constitution and laws of the United States (R. 1-8) was filed on April 7, 1967 (R. 1). Appellees' answer (R. 11-52) was filed on May 8, 1967 (R. 11). On June 15, 1967 (R. 53), appellant filed its motion for summary judgment together with affidavits, exhibits and request to take judicial notice in support thereof (R. 53-77).

On June 20, 1967 (R. 180), appellees filed a cross motion

for summary judgment together with affidavit and exhibits in support thereof (R. 180-186, 125-163).

On July 20, 1967 (R. 187), the District Court rendered a memorandum order denying appellant's motion for summary judgment and granting appellees' motion for summary judgment (R. 187-188). On August 4, 1967 (R. 195), an order and judgment was entered denying appellant's motion for summary judgment, granting appellees' cross motion for summary judgment, and directing judgment in favor of appellees, dismissing the action with costs and disbursements in favor of appellees and against appellant (R. 195-196). Notice of appeal (R. 197-198) was filed on August 16, 1967 (R. 197).

STATEMENT OF THE CASE

1. The complaint alleges that appellant is a California corporation whose principal activity is the publishing of books for national distribution (R. 2) and that among the books published by appellant is a two-volume paperback edition of the writings of Marquis de Sade entitled The Complete Marquis de Sade, translated from the original French text by Dr. Paul J. Gillette (R. 3). The complaint alleges that the writings of Marquis de Sade are of great literary, philosophical, historical and psychological importance (R. 3-4), and that The Complete Marquis de Sade is expression and communication within the free speech and press guarantees of the First and Fourteenth Amendments, and that the publications

are not obscene or otherwise unlawful (R. 4).

It is alleged in the complaint that various owners of retail establishments and distributors have affirmed their readiness to enter into agreements with appellant for the sale and distribution of the aforesaid publications in the city of San Diego (R. 4). Appellees, the Chief of Police of the city of San Diego and the City Attorney for the city of San Diego, threaten to immediately and continuously prosecute the said owners and distributors under penal statutes prohibiting the sale and distribution of obscene books (R. 4). Solely for this reason the owners of retail establishments and distributors in the city of San Diego declined to enter into agreements or business relations with appellant with respect to the sale or distribution of the aforesaid publications in the city of San Diego, although otherwise ready, able and willing to enter into such agreements and business relations (R. 5). The complaint alleges that the conduct of the appellees is arbitrary and capricious, and that appellees threaten to continue in their unlawful conduct so as to permanently exclude the publications from sale and distribution in the city of San Diego (R. 5).

The complaint, in addition to the jurisdictional allegations (R. 1-2), alleges that the acts of appellees were committed under color of law (R. 5); that the conduct of appellees violates appellant's constitutional rights under the First and Fourteenth Amendments (R. 6); that appellees' conduct amounts to an unlawful interference with freedoms of speech and press (R. 6); that said conduct amounts to a previous restraint and restriction on the right of appellant to

circulate the aforesaid publications (R. 6); that appellees' conduct arbitrarily deprives appellant of its liberty and property without due process of law (R. 6); and that appellees assume to act as a censor of the press in direct violation of the fundamental law (R. 6).

The complaint further alleges that the conduct of appellees has caused and threatens to continue to cause irreparable loss and damage to appellant in its standing, reputation and prestige, business and good will (R. 6); that by reason of the conduct of appellees, appellant will suffer great financial loss and be subjected to great expense (R. 6); and that such conduct and threats to continue said course of conduct will deprive the community of the city of San Diego of its right to read books protected from interference and abridgment by the Constitution (R. 7); and that such conduct and threatened conduct has produced and will continue to produce immediate and irreparable injury and loss to appellant, for all of which appellant has no speedy, adequate, or other remedy at law (R. 7).

The prayer of the complaint is for a decree restraining appellees from hindering appellant or any owners of a retail establishment or distributors in the city of San Diego in the sale or distribution of The Complete Marquis de Sade by threats or other acts or practices which interfere with such sale or distribution in the city of San Diego (R. 7), and for a declaration that the conduct of appellees in asserting that the publications are obscene and objectionable is invalid and unauthorized by law and violative of the constitution; that the said publications are not obscene or otherwise

unlawful; and that said publications constitute expressions protected from governmental abridgment and restriction by the First and Fourteenth Amendments (R. 7-8).

2. The answer of appellees generally denies or denies knowledge or information sufficient to form a belief as to the truth of most of the allegations contained in appellant's complaint (R. 11-13). Appellees allege that on January 30, 1967, various owners, or their licensees and agents, of retail establishments engaging in the sale and distribution of the publications The Complete Marquis de Sade, in the city of San Diego, were arrested pursuant to the state obscenity statute (R. 12). Annexed to the answer are copies of criminal complaints filed against the aforesaid owners of the retail establishments (R. 14-52). Appellees also allege that appellant seeks a form of relief prohibited by principle and rule of comity, by doctrine of abstention and the provisions of 28 U.S.C. 2283 (R. 13), and that appellees are immune from the action (R. 3).

The prayer of the answer is that the court strike the allegations contained in paragraph 9 of the complaint (R. 3-4) as being immaterial; and that judgment be rendered for appellees and against appellant (R. 13).

3. Appellant moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure (R. 53-54). In support of the motion for summary judgment, the affidavit of Bentley Morriss affirmed that he was the Vice President of appellant's corporation and the President of the All American

Distributors Corporation, a California corporation. The affidavit alleges that the writings of the Marquis de Sade have appeared in the United States in various editions for the past ten years and that appellant has attempted, by its publication, to present the first English language edition of the four major works of Marquis de Sade. The appellant chose Dr. Paul J. Gillette to translate, edit and adapt the edition of The Complete Marquis de Sade because he is one of the outstanding scholars in classical and modern languages and literature in the United States. Dr. Gillette's expertise is extensive (R. 56-57).

The affidavit of Bentley Morriss further affirms that over 60,000 sets of The Complete Marquis de Sade have been distributed in 49 states throughout the United States, in virtually every major city in the United States, and in approximately 20 foreign countries. Advertisements for The Complete Marquis de Sade were accepted and appeared on various dates in 1966 and 1967 in the New York Times, the Los Angeles Times, the Philadelphia Inquirer, National Best Sellers, and in Publishers Weekly (R. 57). No criminal actions involving the publications, other than the ones instituted in the city of San Diego, have taken place anywhere in the United States (R. 58).

It is further alleged in the affidavit that the writings of de Sade have received wide publication and distribution and have been published in various editions. The ideas of de Sade have been discussed by literally hundreds of writers and scholars in the varied fields of literary criticism, psychology, philosophy and

history. Contemporary literary critics, writing in such publications as the New York Times, Book Week, News Week and Saturday Review, have stressed the importance of de Sade's writings (R. 58). The affidavit stresses the social importance of the writings of de Sade, as well as the fact that the descriptions of sex contained therein are within customary freedom of expression (R. 58-59).

The affidavit states that the conduct of appellees in admittedly arresting and prosecuting various owners of retail establishments engaged in the sale and distribution of The Complete Marquis de Sade has brought to a halt the circulation of the said publications in the city of San Diego, despite the fact that owners of retail establishments are willing to enter into agreements with appellant for the sale and distribution of the said publications (R. 59). It is affirmed that the conduct of the appellees and their threats to continue such unlawful conduct has resulted, and will result, in permanently excluding the publications from sale and distribution in the city of San Diego, and that such curtailment of circulation will cause appellant to suffer substantial and irreparable loss and damage, for which he has no adequate remedy at law (R. 59-60).

Also submitted with the motion for summary judgment were requests for the Court to take judicial notice of rulings of the United States Supreme Court and other courts in federal and state jurisdiction holding comparable material to be constitutionally protected under the First and Fourteenth Amendments to the United

States Constitution (R. 63-77).

In opposition to appellant's motion for summary judgment as aforesaid, appellees interposed a memorandum of points and authorities (R. 164-166). The gist of appellees' legal argument was that "triable issues of fact exist as to the question of obscenity" and that the doctrine of abstention was applicable.

4. At the same time, appellees filed a cross motion for summary judgment (R. 180-181). In support of the cross motion the affidavit of Kenneth H. Lounsberry, Deputy City Attorney of the city of San Diego, alleged that various arrests had been made of different owners of retail establishments for the sale and distribution of The Complete Marquis de Sade in purported violation of the state obscenity statute (R. 182-186), and incorporated therein were copies of the criminal complaints against the various retail owners (R. 125-163). A memorandum of points and authorities in support of said cross motion for summary judgment emphasized that appellant was allegedly barred from seeking relief by the doctrine of abstention and that appellant had failed to show irreparable injury (R. 167-179).

5. A memorandum order was rendered by the District Court denying appellant's motion for summary judgment and granting appellees' motion for summary judgment (R. 187-188). The District Court noted that it appeared from the affidavit in support of appellant's motion for summary judgment that San Diego is the only place in the United States where prosecutions were pending, despite the wide distribution of the book, and that other affidavits

filed by appellant attest to the book's "redeeming social value" (R. 187). The District Court noted that appellees contended that the Court should abstain from acting, pending a decision by the state courts (R. 187-188). The District Court stated:

> "Having in mind the case of Redrup v. State of New York, 35 L. W. 4396 (U. S. Supreme Court, May 8, 1967), a conclusion cannot be reached that plaintiff's constitutional rights are being violated by the prosecution or threatened prosecution of distributors and sellers of the book." (R. 188).

Judgment was rendered accordingly (R. 195-196).

The questions involved in the light of the foregoing are as follows: (a) whether, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court, the District Court erred in dismissing the action; (b) whether, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court, the doctrine of abstention was properly invoked in the case herein; (c) whether, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court, the District Court erred in granting appellees' cross motion for summary judgment; (d) whether, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court, the District Court erred in denying appellant's motion for summary judgment; (e) whether the judgment and order of the District Court deprives appellant of rights guaranteed by law and rights guaranteed by the Constitution of the United States,

including the free speech and press and due process provisions of the First and Fourteenth Amendments.

SPECIFICATION OF ERRORS

1. The District Court erred in dismissing the action, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court.

2. The District Court erred in invoking the doctrine of abstention, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court.

3. The District Court erred in granting appellees' cross motion for summary judgment, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court.

4. The District Court erred in denying appellant's motion for summary judgment, contrary to law, the Constitution and the applicable decisions of the United States Supreme Court.

5. The District Court erred in rendering the order and judgment in the cause herein, contrary to the rights guaranteed to appellant by law and the Constitution of the United States.

SUMMARY OF ARGUMENT

The facts alleged in appellant's complaint show that appellees, while acting under color of law, deprived and threatened to deprive appellant of rights secure to appellant by the provisions of the First

and Fourteenth Amendments and the laws of the United States. It is established that an action under the Civil Rights Act will not be dismissed for failure to state a claim, unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. The complaint herein for declaratory and injunctive relief was clearly not subject to dismissal.

The thrust of the complaint is directed against the censorship imposed by appellees in the City of San Diego with respect to the publication, The Complete Marquis de Sade. The complaint did not seek to enjoin any state criminal prosecution; it sought only a declaration that appellees were engaged in conduct which constitutes a prior restraint on the circulation of a publication entitled to constitutional protection, and that appellees be enjoined from such unlawful conduct. The precise issue has been decided by this Court in Corsican Productions v. Pitchess, 338 F. 2d 441 (9 Cir., 1964), holding that a similar complaint against local officials was erroneously dismissed by a district court.

Abstention, under the circumstances here presented, constitutes an abdication of federal judicial responsibility to exercise jurisdiction conferred by the Congress and the Constitution for the protection of federally created rights. Appellant was not compelled to seek relief in any form in any state court because the assertion of a federal claim in a federal court does not have to await an attempt to vindicate the same claim in a state court. That the doctrine of abstention was inappropriately invoked by the court below is clear

from the recent decision of the United States Supreme Court in Zwickler v. Koota, 389 U.S. 241, 88 S. Ct. 291, 19 L. Ed. 2d 444, and other decisions of the Supreme Court in the same area.

The District Court erred in granting appellees' cross motion for summary judgment. The cross motion was no more than a motion to dismiss the complaint, based on the doctrine of abstention. Appellant's standing to institute the action herein cannot be successfully questioned. Appellant has suffered palpable injury as a result of the actions of appellees acting under color of law. Appellant is not arguing another's constitutional rights. The constitutional guarantee of freedom of the press includes both the publication and circulation of books. The direct and obviously intended result of appellees' activities is to curtail the circulation in the City of San Diego of The Complete Marquis de Sade, published by appellant.

The District Court erred in denying appellant's motion for summary judgment. At the very least, if the District Court believed that triable issues were presented, then the case should have been set down for trial and determination.

In opposition to appellant's motion for summary judgment, appellees themselves argued that triable issues of fact exist as to the question of obscenity. However, on the uncontradicted record presented below, appellant established in support of its motion for summary judgment that the publication was not obscene and entitled to constitutional protection. The uncontradicted record showed that the publication does not exceed contemporary community

standards in the depiction of sex, does not appeal to a prurient interest, and has great social importance. Nevertheless, if the District Court felt that the issue could not be decided as a matter of law and that a hearing was necessary to establish that the publication was entitled to constitutional protection, then the District Court should have ordered a hearing and taken evidence instead of dismissing the action. Dismissal of the action deprived the appellant unlawfully of access to the federal court and deprived it of fundamental legal and constitutional rights guaranteed to appellant by the laws and the Constitution of the United States.

ARGUMENT

I

THE FACTS ALLEGED IN THE COMPLAINT SHOW THAT APPELLEES, WHILE ACTING UNDER COLOR OF LAW, DEPRIVED AND THREATENED TO DEPRIVE APPELLANT OF RIGHTS SECURED TO APPELLANT BY THE PROVISIONS OF THE FIRST AND FOURTEENTH AMENDMENTS AND THE LAWS OF THE UNITED STATES. SINCE APPELLANT PRESENTED A PROPER CLAIM FOR DECLARATORY AND EQUITABLE RELIEF, THE DISTRICT COURT ERRED IN INVOKING THE DOCTRINE OF ABSTENTION.

(a) Appellant discusses initially in this brief the sufficiency of the cause of action stated in the complaint. Appellant contends that the complaint states a claim upon which relief could be granted by a federal district court. Under these circumstances, it is urged that the doctrine of abstention was improperly invoked

by the District Court.

In the points which follow, appellant discusses the motions for summary judgment which were made by the respective parties. It is there asserted that appellees' cross motion for summary judgment was essentially no more than a motion to dismiss the complaint on the sole ground of abstention. It is then urged that appellant's motion for summary judgment should have been granted or, in the alternative, the case should have been set down for trial.

It is, of course, the accepted rule that an action will not be dismissed for failure to state a claim, unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. Conley v. Gibson, 355 U. S. 41, 78 S. Ct. 99, 2 L. Ed. 2d 80; Marshall v. Sawyer, 301 F. 2d 639 (9 Cir. 1962); Cohen v. Norris, 300 F. 2d 24 (9 Cir. 1962); York v. Story, 324 F. 2d 450 (9 Cir. 1963).

In the light of the aforesaid general rule, it is clear that the complaint herein is not subject to dismissal. The complaint alleges that appellant published a two-volume paperback edition of the writings of Marquis de Sade, entitled The Complete Marquis de Sade; that various owners of retail establishments and distributors wished to sell and distribute the publication in the city of San Diego; that the Chief of Police and City Attorney of that city (the appellees) threatened to prosecute the owners of retail establishments and distributors of the publication under the state obscenity statute; that solely because of appellees' conduct the sale and distribution

of the publication in the city of San Diego was, and will continue to be, prevented. Appellant prayed for a declaration that the conduct of appellees was unauthorized by law and violative of the Constitution, and that the publication was constitutionally protected, and for an order restraining appellees from interfering with the sale and distribution of the publication.

It is plain that the thrust of the complaint herein is directed against the censorship which appellees have invoked. The complaint did not allege that appellant had been subjected to any criminal prosecution, nor did the complaint seek to enjoin any state prosecution. What the appellant sought in the complaint was a declaration that appellees were engaged in conduct, by threats of prosecution and other acts, which constituted a censorship and prior restraint on the circulation of a writing ordinarily protected from governmental infringement by the Constitution of the United States, and that appellees be enjoined from such unlawful conduct. That such "informal censorship may sufficiently inhibit the circulation of publications to warrant injunctive relief" is well established. Bantam Books, Inc. v. Sullivan, 372 U. S. 58, 67-68, 83 S. Ct. 631, 9 L. Ed. 2d 584. See also, Freedman v. Maryland, 380 U. S. 51, 85 S. Ct. 734, 13 L. Ed. 2d 649; Zenith Int'l Film Corp. v. City of Chicago, 291 F. 2d 785 (7 Cir. 1961); Capital Enterprises, Inc. v. City of Chicago, 260 F. 2d 670 (7 Cir. 1958); Columbia Pictures Corp. v. City of Chicago, 184 F. Supp. 817 (D. C. Ill. 1959); In re Louisiana News Co. v. Dayries, 187 F. Supp. 241 (D. C. La. 1960) opinion by three-judge Court; HMH Pub. Co. v.

Garrett, 151 F. Supp. 903 (D.C. Ind. 1957); Dearborn Pub. Co. v. Fitzgerald, 271 Fed. 479 (D.C. Ohio 1912); New American Library of World Literature v. Allen, 114 F. Supp. 823 (D.C. Ohio, 1953).

The precise issue has, in any event, been decided by this Court. Corsican Productions v. Pitchess, 338 F.2d 441 (9 Cir. 1964). In that case, the producer of a motion picture film filed a complaint under the same Civil Rights Act as is involved herein, seeking declaratory and injunctive relief as well as damages. The complaint similarly alleged that various motion picture exhibitors wished to exhibit the film in the County of Los Angeles and that the Deputy Sheriff and District Attorney of that county threatened to prosecute exhibitors of the film under the state penal statute. The complaint was dismissed in the District Court on the ground that it did not state a claim upon which relief could be granted and that abstention was required as a matter of comity. This Court reversed and held that the producer had standing to institute the action, that the complaint stated a claim for relief against the censorship initiated by the local officials in the County of Los Angeles.

(b) It is now settled that abstention under the circumstances here presented constitutes an abdication of federal judicial responsibility to exercise jurisdiction conferred by the Congress and the Constitution for the protection of federally created rights. In Zwickler v. Koota, 389 U.S. 241, 88 S. Ct. 291, 19 L. Ed. 2d 444 (decided December 5, 1967), the state statute made it a crime

to distribute handbills in an election anonymously. An accused was convicted of violating the statute, but obtained a reversal on state law grounds. Thereafter, the same person instituted an action in the federal district court under the Civil Rights Act, seeking declaratory and injunctive relief upon the ground that the state statute was invalid on its face under the First Amendment and an injunction was required to prevent further prosecution under the said law. A three judge court applied the doctrine of abstention and dismissed the case. The United States Supreme Court reversed, holding that abstention was inappropriate, insofar as declaratory relief had been sought, wholly apart from the question as to whether injunctive relief could or could not be granted. The Supreme Court held,

1) that the Civil Rights Act imposes "the duty upon all levels of the federal judiciary to give due respect to a suitor's choice of a federal forum for the hearing and decision of his federal constitutional claims" (88 S. Ct. at 395);

2) that the doctrine of abstention sanctions escape from such statutory duty only in "narrowly limited 'special circumstances' " (88 S. Ct. at 395); where a construction or interpretation of a statute is not involved, it is the duty of a federal court to decide all federal constitutional questions presented to it;

3) that abstention "cannot be ordered simply to give state courts the first opportunity to vindicate the

federal claim" (88 S. Ct. at 397);

4) that a plaintiff who has commenced a federal action may not be required to suffer the delay of state court proceedings, which delay "might itself effect the impermissible chilling of the very constitutional right he seeks to protect" (88 S. Ct. at 397-398);

5) that a request for a declaratory judgment must be considered independently of any request for injunctive relief; a federal district court "has the duty to decide the appropriateness and the merits of the declaratory request, irrespective of its conclusion as to the propriety of the issuance of the injunction". (88 S. Ct. at 399).

See also, Monroe v. Pape, 365 U.S. 167, 81 S. Ct. 473, 5 L. Ed. 2d 492; Reynolds v. Sims, 377 U.S. 533, 566, 84 S. Ct. 1362, 12 L. Ed. 2d 506; Dombrowski v. Pfister, 380 U.S. 479, 85 S. Ct. 1116, 14 L. Ed. 2d 22; McNeese v. Bd. of Education etc., 373 U.S. 668, 83 S. Ct. 1433, 10 L. Ed. 2d 622; Keyishian v. Bd. of Regents, 385 U.S. 589, 87 S. Ct. 675; Baggett v. Bullitt, 377 U.S. 360, 87 S. Ct. 1316, 12 L. Ed. 2d 377; Corsican Productions v. Pitchess, 338 F. 2d 441 (9 Cir. 1964).

Here, the appellant publisher and distributor instituted an action in the federal courts under the Civil Rights Act, seeking a declaration that the threats and other acts and conduct of appellees constituted an impermissible restraint on the circulation of appellant's publication, in violation of the free speech and press and

due process provisions of the First and Fourteenth Amendments, and appellant sought a declaration that the publication involved was entitled to constitutional protection because it was not obscene nor otherwise unlawful. The appellant sought to enjoin such threats and unlawful conduct, and did not seek to restrain any state criminal prosecutions. Under the circumstances, it was the plain duty of the District Court, it is submitted, under the applicable decisions of the United States Supreme Court, to adjudicate the subject matter of the action. Appellant was not compelled to seek relief in any form in any state court because the assertion of a federal claim in a federal court does not have to await "an attempt to vindicate the same claim in a state court". Zwickler v. Koota, 88 S. Ct. at 397.

II

THE DISTRICT COURT ERRED IN GRANTING APPELLEES' CROSS MOTION FOR SUMMARY JUDGMENT. THE CROSS MOTION WAS NO MORE THAN A MOTION TO DISMISS THE COMPLAINT, BASED ON THE DOCTRINE OF ABSTENTION, AND THE GRANT OF SUCH MOTION CONSTITUTED AN ABDICATION OF JUDICIAL RESPONSIBILITY REQUIRED BY LAW AND A DEPRIVATION OF APPELLANT'S RIGHTS UNDER THE CONSTITUTION AND LAWS OF THE UNITED STATES.

The sole affidavit in support of appellees' cross motion for summary judgment (R. 180-181) was made by a Deputy City Attorney of the City of San Diego (R. 182-186). The affidavit recited essentially no more than a history of the prosecutions instituted

against certain owners of retail establishments in the City of San Diego who were charged with distributing The Complete Marquis de Sade in violation of the state obscenity statute. The memorandum of points and authorities in support of the motion (R. 167-179) emphasized solely that appellant was seeking a form of relief allegedly prohibited by principles of comity, the doctrine of abstention and 28 U. S. C. 2283 involving grants of injunctions by a federal court staying proceedings in a state court. The memorandum order of the District Court noted that the contention of appellees was that the Court should abstain from acting, pending decision by the state courts, the appellees relying principally upon a ruling of the Court of Appeals for the Third Circuit. Outdoor American Corporation v. Philadelphia, 333 F. 2d 963 (1964) (R. 187-188).

Reliance upon Outdoor American Corporation by appellees is obviously misplaced. In the first place, actual criminal prosecutions had been instituted against one of the plaintiffs and injunction relief was sought against pending criminal prosecutions. In the second place, the Court of Appeals for the Third Circuit placed principal reliance upon the decision of the Supreme Court in Douglas v. City of Jeannette, 319 U. S. 157, 63 S. Ct. 877, 87 L. Ed. 1324, a case which this Court, in Corsican Productions v. Pitchess, 338 F. 2d 441, 443, held was inapplicable under the circumstances presented by the facts and pleadings. In the third place, the recent decision of the United States Supreme Court in Zwickler v. Koota, 389 U. S. 241, 88 S. Ct. 291, 19 L. Ed. 2d 444, makes clear that

abstention is not appropriate where declaratory relief is sought, wholly apart from questions relating to the grant of injunctive relief.

Moreover, it should be noted that the Supreme Court stated in Zwickler v. Koota: "It is better practice, in a case raising a federal constitutional or statutory claim, to retain jurisdiction, rather than to dismiss." (88 S. Ct. at 399, f. n. 4).

The fact is that no grounds were presented by appellees which justified the granting of the cross motion for summary judgment below. The appellees admitted that they had instituted prosecutions against some nine different individuals for alleged violations of the state obscenity statute by reason of the distribution of The Complete Marquis de Sade. It was undisputed and clearly obvious that the actions of appellees had made it impossible for appellant to enter into any business relations with any retail book seller in the City of San Diego and that an effective censorship had been placed upon the publication by reason of the conduct of appellees. As the Supreme Court has time and again indicated, it is completely irrelevant, in an action in a federal court seeking declaratory and injunctive relief under the Civil Rights Act, for law officers to assert that pending criminal prosecutions against retailers are an obstacle to the assertion of fundamental legal and constitutional rights in the federal courts under a congressional enactment. As was stated in Drombrowski v. Pfister, 380 U. S. 479, 85 S. Ct. 1116, 14 L. Ed. 2d 22:

"A criminal prosecution under a statute regulating

expression usually involves imponderables and contingencies that themselves may inhibit the full exercise of First Amendment freedoms. . . . The assumption that defense of a criminal prosecution will generally assure ample vindication of constitutional rights is unfounded in such cases. See Baggett v. Bullitt, supra, 377 U.S. at 379, 84 S. Ct. at 1326. For '(t)he threat of sanctions may deter * * * almost as potently as the actual application of sanctions. * * * ' NAACP v. Button, 371 U.S. 415, 433, 83 S. Ct. 328, 338, 9 L. Ed. 2d 405. . . . Moreover, we have not thought that the improbability of successful prosecution makes the case different. The chilling effect upon the exercise of First Amendment rights may derive from the fact of the prosecution, unaffected by the prospects of its success or failure." (380 U.S. at 486-487). See also Zwickler v. Koota, 389 U.S. 241, 88 S. Ct. 291, 19 L. Ed. 2d 444.

Appellant's standing to institute the action herein cannot be successfully questioned, it is submitted. The appellant has, in fact, suffered palpable injury as a result of the acts alleged to violate federal law, and the injury is a legal injury caused by violations of the Constitution of the United States. If this were a private action, it would present the claim, plainly justiciable, of unlawful interference in advantageous business relations. So far as

appellant's standing is concerned, it makes no difference that the allegedly unlawful interference is the product of state action. Moreover, appellant is not arguing another's constitutional rights. The constitutional guarantee of freedom of the press embraces both the publication and circulation of books as well. The direct and obviously intended result of appellees' activities is to curtail the circulation in the City of San Diego of The Complete Marquis de Sade published by appellant. See, Bantam Books, Inc. v. Sullivan, 372 U.S. 58, 64 f.n. 6, 83 S. Ct. 631, 636, 9 L.Ed.2d 584.

III

THE DISTRICT COURT ERRED IN DENYING APPELLANT'S MOTION FOR SUMMARY JUDGMENT. AT THE VERY LEAST, IF THE DISTRICT COURT BELIEVED THAT TRIABLE ISSUES WERE PRESENTED, THEN THE CASE SHOULD HAVE BEEN SET DOWN FOR TRIAL AND DETERMINATION. THE JUDGMENT AND ORDER OF THE DISTRICT COURT DEPRIVES APPELLANT OF RIGHTS GUARANTEED TO APPELLANT BY LAW AND THE PROVISIONS OF THE CONSTITUTION.

(a) In opposition to appellant's motion for summary judgment, the appellees presented only two arguments in their memorandum of law:

1. "Triable issues of fact exist as to the question of obscenity." (R. 164-165).

2. "The doctrine of abstention." (R. 166).

On the other hand, the appellant, in support of its motion for summary judgment, established without contradiction in the record that The Complete Marquis de Sade has been distributed in 49 states throughout the United States, in virtually every major city in the United States and approximately 20 foreign countries (R. 57). It was undisputed that advertisements had been accepted and appeared in leading newspapers and magazines with regard to the publication (R. 57). The fact that the writings of de Sade have great social importance was also not contradicted in any respect. That The Complete Marquis de Sade would appeal to a person's interest in literature, the arts, philosophy, history, psychiatry and political science was also undisputed (R. 58-59). The papers in support of the motion also demonstrated that books and other media of communication, with far less social importance and with equal candor and description of sex, had received judicial approval by the United States Supreme Court and the highest courts of various state jurisdictions (R. 63-77). See, Grant v. United States, 380 F.2d 478 (9 Cir. 1967), holding that the books Swish! Bottom!, Screaming Flesh and The Holdout are entitled to constitutional protection. See also, Grove Press, Inc. v. Gerstein, 378 U.S. 577, 84 S. Ct. 1909, 12 L. Ed. 1305 (Tropic of Cancer); Tralins v. Gerstein, 378 U.S. 576, 84 S. Ct. 903, 12 L. Ed. 2d 1033 (Pleasure Was My Business); Memoirs v. Massachusetts, 383 U.S. 413, 86 S. Ct. 975, 16 L. Ed. 2d 1 (Fanny Hill); Redrup v. New York, 386 U.S. 767, 87 S. Ct. 1414, 18 L. Ed. 2d 515 (Lust Pool and Shame Agent); Aday v. United States, 388 U.S. 447,

87 S. Ct. 2095, 18 L. Ed. 2d 1309 (Sex Life of a Cop); Books, Inc. v. United States, 388 U.S. 449, 87 S. Ct. 2098, 18 L. Ed. 2d 1311 (Lust Job); Quantity of Copies of Books v. Kansas, 388 U.S. 452, 87 S. Ct. 2104, 18 L. Ed. 2d 1314 (Sin Hooked, Bayou Sinners, Lust Hungry, Shame Shop, Fleshpot, Sinners Seance, Passion Priestess, Penthouse Pagans, Shame Market, Sin Warden and Flesh Avenger); Corinth Publications, Inc. v. Wesberry, 388 U.S. 448, 87 S. Ct. 2096, 18 L. Ed. 2d 1310 (Sin Whisper); Keney v. New York, 388 U.S. 440, 87 S. Ct. 2091, 18 L. Ed. 2d 1302 (Sin Servant, Lust School and Lust Web); Mazes v. Ohio, 388 U.S. 453, 87 S. Ct. 2105, 18 L. Ed. 2d 1315 (Orgy Club); Friedman v. New York, 388 U.S. 441, 87 S. Ct. 2091, 18 L. Ed. 2d 1303 (publications entitled: "Bondage Boarding School", "English Spanking School", "Bound and Spanked", "Sweeter Gwen", "Travelling Saleslady Gets Spanked", "Bound to Please", "Bizarre Summer Rivalry", "Heat Wave", "Escape Into Bondage, Book No. 2"); Sheperd v. New York, 388 U.S. 444, 87 S. Ct. 2093, 18 L. Ed. 2d 1306 (sets of photographs and publications entitled: "Promenade Bondage", "Spanking Nurses", "Spanking Sisters" and "Bondage"); Avansino v. New York, 388 U.S. 446, 87 S. Ct. 2093, 18 L. Ed. 2d 1308 (packets of photographs and publication entitled "Promenade Bondage Vol. 4"); Chicago v. Kimmel, 31 Ill. 2d 200, 201 N.E. 2d 386 (1964) (Campus Mistress and Born to be Made); People v. Bruce, 31 Ill. 2d 459, 202 N.E. 2d 497 (1964) (allegedly obscene performance); Chicago v. Universal Publishing & Distributing Corp., 34 Ill. 2d 250, 215 N.E. 2d 251 (1966) (Instant Love, Marriage

Club, Love Hostess, The Shame of Jenny, High-School Scancal, Her Young Lover and Cheater's Paradise); People v. Romaine, 38 Ill. 2d 325, 231 N. E. 2d 413 (1967) (Fanny Hill) and Commonwealth v. Dell Publications, Inc., et al., 233 A. 2d 840 (Pa. 1967), holding the book Candy to be entitled to constitutional protection.

On the undisputed record, therefore, it is submitted that appellant was entitled to summary judgment in declaring that the publication, The Complete Marquis de Sade, is entitled to constitutional protection and that the censorial activities of the appellees should be restrained.

(b) On this issue, the memorandum opinion of the District Court merely states the following:

> "Having in mind the case of Redrup v. State of New York, 35 L. W. 4396 (U. S. Supreme Court, May 8, 1967), a conclusion cannot be reached that plaintiff's constitutional rights are being violated by the prosecution or threatened prosecution of distributors and sellers of the book."

In Redrup v. New York, 386 U. S. 767, 87 S. Ct. 1414, 18 L. Ed. 2d 515, the Supreme Court rendered a per curiam opinion in three consolidated state cases involving attempts by different states to suppress distribution of books and magazines through criminal or civil proceedings. In one case (Redrup), the books involved were entitled Lust Pool and Shame Agent. In the second case (Austin), there were two magazines involved entitled "High

Heels" and "Spree". In the third case (Gent), the magazines involved were "Gent", "Swank", "Bachelor", "Modern Man", "Cavalcade", "Gentlemen", "Ace" and "Sir".

The Supreme Court held that all of the aforesaid material was entitled to constitutional protection. The Court stated: "We have concluded, in short, that the distribution of the publications in each of these cases is protected by the First and Fourteenth Amendments from governmental suppression, whether criminal or civil, in personam or in rem." (386 U.S. at 770).

It is not clear from the memorandum opinion of the District Court as to what the reference to Redrup was intended to signify. The Court indicates that a conclusion cannot be reached that appellant's constitutional rights are being violated by the prosecution of retail book sellers in the light of Redrup. If this was intended to mean that the District Court thought it proper to invoke the doctrine of abstention in the light of the Redrup decision, then it is respectfully submitted the Court was in error. As has heretofore been discussed, appellant was seeking declaratory relief with respect to the censorial activities of appellees and the right of the publication to constitutional protection. Appellant was not requesting any injunctive relief against state criminal prosecutions. The decisions by the United States Supreme Court in Redrup itself supports the view that appellant's constitutional rights were being violated by the conduct of appellees and appellant was entitled to seek relief in a federal forum under a federal law granting the federal district court power and jurisdiction to grant the relief requested. The

decisions in Zwickler v. Koota, 389 U.S. 241, 88 S. Ct. 291, 19 L. Ed. 2d 444; Drombrowski v. Pfister, 380 U.S. 479, 85 S. Ct. 1116, 14 L. Ed. 2d 22; Corsican Productions v. Pitchess, 338 F. 2d 441, 443; and other decisions heretofore cited clearly establish appellant's right to relief.

The memorandum opinion of the District Court may, on the other hand, indicate that the District Court felt that the issue could not be decided as a matter of law. As was noted aforesaid, the appellees urged that triable issues of fact allegedly existed as to the question of obscenity. If the District Court was of this view, then it is submitted that the case should have been set down for trial instead of rendering a judgment dismissing the action. (Federal Rules of Civil Procedure, Rule 56).

In determining whether a publication is not obscene and entitled to constitutional protection, "three elements must coalesce: it must be established that (a) the dominant theme of the material, taken as a whole, appeals to a prurient interest in sex; (b) the material is patently offensive because it affronts contemporary community standards relating to the description or representation of sexual matters; and (c) the material is utterly without redeeming social value". Memoirs v. Massachusetts, 383 U.S. 413, 418, 86 S. Ct. 975, 977, 16 L. Ed. 2d 1. Each of the three aforesaid federal constitutional criteria must be applied independently.

Appellant's motion for summary judgment amply established without essential contradiction that The Complete Marquis de Sade

does not go beyond contemporary community standards in depiction of sex; does not appeal to a prurient interest, i. e., a shameful or morbid interest in sex; and has great social importance. See, Culbertson v. California, 385 F. 2d 209 (9 Cir. 1967), reversing a judgment of the United States District Court for the Southern District of California and directing that a petition for writ of habeas corpus be granted, upon the ground that the conviction of a retail owner under the state obscenity statute was unconstitutional, based upon material entitled to constitutional protection under the decisions of the United States Supreme Court in Redrup and other related cases.

Nevertheless, if the District Court was uncertain as to whether the questions presented could be decided as a matter of law, then the issues of contemporary standards, prurient interest and social importance should have been set down for trial for appropriate disposition. Cf. Commonwealth v. Moniz, 336 Mass. 178, 143 N. E. 2d 196 (1957), 155 N. E. 2d 762 (1959). Dismissal of the action deprived appellant unlawfully of access to the federal courts and deprived it of fundamental legal and constitutional rights guaranteed to appellant by the laws and the Constitution of the United States.

CONCLUSION

For all the foregoing reasons, the judgment in order of the District Court should be reversed.

Respectfully submitted,

STANLEY FLEISHMAN and

GOSTIN & KATZ

By: STANLEY FLEISHMAN

Attorneys for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Stanley Fleishman
STANLEY FLEISHMAN

No. 22361

United States Court of Appeals

FOR THE NINTH CIRCUIT

HOLLOWAY HOUSE PUBLISHING CO., a California corporation, Appellant, vs. WESLEY S. SHARP, individually, and as Chief of Police of the City of San Diego, and EDWARD T. BUTLER, individually, and as City Attorney for the City of San Diego, Respondents.	No. 22361 RESPONDENTS' BRIEF

On Appeal From the United States District Court
For the Southern District of California

BRIEF OF THE CITY OF SAN DIEGO

AS RESPONDENT

EDWARD T. BUTLER, City Attorney
KENNETH H. LOUNSBERY, Deputy City Attorney
BARBARA FLOOD, Legal Intern
City Administration Building
San Diego, California 92101

Attorneys for Respondent

SUBJECT INDEX

TABLE OF AUTHORITIES CITED

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LOWAY HOUSE PUBLISHING CO., ifornia corporation,	)	
Appellant,	)	No. 22361
vs.	)	
LEY S. SHARP, individually, and as f of Police of the City of San Diego, EDWARD T. BUTLER, Individually, as City Attorney for the City of San Diego,	)	RESPONDENTS' BRIEF
Respondents.	)	

STATEMENT OF THE CASE

On April 7, 1967, the Holloway House Publishing Company, appellant rein, filed this action in the United States District Court for the Southern District one, restrain the Chief of Police, his agents, and the City Attorney, the re- ondents herein, from interfering with the sale or distribution of material pub- hed by appellant called "The Complete Marquis de Sade" in the City of San ego and two, for a declaration that the said publication is not obscene. On Jan- ry 30, 1967, the respondents had arrested several retail bookstore owners who d sold the above-described publication, all of whom were customers of appel- nt, and criminal prosecutions were instituted in the state courts for violations the state obscenity law. [1]

California Penal Code
"Section 311. Definitions
As used in this chapter:
(a) 'Obscene' means that to the average person, applying contemporary standards, the predominant appeal of the matter, taken as a whole, is to purient interest, i.e., a shameful or morbid interest in nudity, sex, or excretion, which goes substantially beyond customary limits of candor in description or representation of such matters and is matter which is utterly without redeeming social importance.
(b) 'Matter' means any book, magazine, newspaper, or other printed or written material or any other picture, drawing, photograph, motion picture, or other pictorial representation or any statue or other figure, or any recording, transcription or mechanical, chemical or electrical reproduction or any other articles, equipment, machines or materials.
(c) 'Person' means any individual, partnership, firm, association, corporation, or other legal entity.
(d) 'Distribute' means to transfer possession of, whether with or without consideration.
(e) 'Knowingly' means having knowledge that the matter is obscene. (Added Stats. 1961, c. 2147, p. 4427, §5.)"

California Penal Code Section

"311.2 Sending or bringing into state for sale or distribution; printing,

(continued on following page)

The arrests of January 30 resulted in three criminal cases involving a t of nine defendants. These cases are currently at various stages of litigation i California courts. The first case to come to trial resulted in an August 16, 1 conviction of the defendant by a Municipal Court jury, which conviction is now appeal before the San Diego Superior Court Appellate Department. In that app the appellant's opening brief has been filed, the respondent's brief must be fil by May 8, 1968, appellant's reply brief is due five days thereafter, and argun is set for May 17, 1968. The two remaining cases have been continued pendir outcome of the appeal; trial dates of June 10, 1968 and July 8, 1968 have been

It must be stressed here that no threats of prosecution were ever made respondents to appellant or to any of appellant's customers, either prior to th arrests pursuant to the state Penal Code or at any subsequent time. No actic has been taken by respondents against appellant, and at no time have respondr

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1. (Continued from preceding page)
exhibiting, distributing or possessing within state
Every person who knowingly: sends or causes to be sent, or brings or causes to be brought, into this State for sale or distribution, or in this S prepares, publishes, prints, exhibits, distributes, or offers to distribt or has in his possession with intent to distribute or to exhibit or offer t distribute, any obscene matter is guilty of a misdemeanor (Added Sta 1961, c. 2147, p. 4428, § 5.)"

2. Documentation of the state criminal proceedings is part of the record i case. Certified copies of the state criminal complaints were attached o and incorporated in respondents' Answer to appellant's Complaint. Exhil A and B attached to and incorporated in Defendants' Cross Motion for Sur mary Judgment in the District Court also indicated the parties and action the state court. The first case tried involved defendants Henderson and Hartman. The Municipal Court proceedings began on July 3, 1967 with preliminary motions, arguments and voir dire, the actual trial started on July 26, 1967, charges against Hartman were dismissed during trial and Henderson was convicted on August 16, 1967. Attorneys for appellantne in defended Henderson in the criminal trial.

ıed appellant with criminal prosecution by reason of the sale or continued
ion or distribution of "The Complete Marquis de Sade."

STATEMENT OF THE PROCEEDINGS BELOW

On April 7, 1967, this action was filed by appellant in the United States Dis-
urt for the Southern District of California. Motions for summary judg-
ere filed by both parties. On June 26, 1967, argument on the respective
was heard by the District Court judge. On July 20, 1967, the District
endered a memorandum order denying appellant's motion for summary
ıt and granting respondents' cross motion for summary judgment. On
4, 1967, an order was entered denying appellant's motion for summary
ıt, granting respondents' cross motion for summary judgment, and
g judgment in favor of respondents. This is an appeal from that judgment.

ARGUMENT

I

THE DOCTRINE OF ABSTENTION

Every federal court that is petitioned to grant injunctive relief where a
oceeding is pending must initially consider the possible application of
trine of Abstention. This doctrine, established in Railroad Commission
s v. Pullman Co. (1940) 312 U. S. 496 [85 L. Ed. 971] [61 S. Ct. 643] is
n two well-recognized rules. One, by awaiting state action the considera-
federal courts of constitutional questions may become unnecessary, and

two, state courts should be given the first opportunity to interpret state statute

The key case in which the doctrine is interpreted and applied is Douglas City of Jeannette (1942) 319 U.S. 157 [87 L. Ed. 1324] [63 S. Ct. 877]. In that case the United States Supreme Court ruled that a hearing wherein an injunctio is sought on substantive grounds may only be obtained after the plaintiff has ov come the initial burden of establishing a cause of action in equity.

> "It is a familiar rule that courts of equity do not ordinarily restrain criminal prosecutions. No person is immune from prosecution in good faith for his alleged criminal acts. Its imminence, even though alleged to be in violation of constitutional guaranties, is not a ground for equity relief since the lawfulness or constitutionality of the statut or ordinance on which the prosecution is based may be determined as readily in the criminal case as in a suit for an injunction. (Citations omitted.) Where the threatened prosecution is by state officers for alleged violations of a state law, the state courts are the final arbite of its meaning and application, subject only to review by this Court on federal grounds appropriately asserted. Hence the arrest by the federal courts of the processes of the criminal law within the states, and the determination of questions of criminal liability under state law by a federal court of equity, are to be supported only on a showing of danger of irreparable injury 'both great and immediate.'" (at pages 163-164.)

There are sound reasons for this initial scrutiny by the federal courts t determine the propriety of the proposed hearing. In Stefanelli v. Minard (19 342 U.S. 117 [96 L. Ed. 138] [72 S. Ct. 118] Justice Frankfurter delivered the ion of the Supreme Court and expressed what is generally regarded to be the most reason for the application of the Doctrine of Abstention. The applicatio this doctrine was even found to exceed in importance the compelling case brog under the Civil Rights Act.

> "(E)ven if the power to grant the relief here sought may fairly and constitutionally be derived from the generality of language of the Civil Rights Act, to sustain the claim would disregard the power of

courts of equity to exercise discretion when, in a matter of equity jurisdiction, the balance is against the wisdom of using their power. Here the considerations governing that discretion touch perhaps the most sensitive source of friction between States and nation, namely, the active intrusion of the federal courts in the administration of the criminal law for the prosecution of crimes solely within the power of the States." (at page 120)

The unmistakable call of the above cases, and of the statutory law expressive principle of those cases, [3] is for the application of the Doctrine of Abstention even the factual circumstances that are evident in this case. Regardless of principle the appellant resists the application of the doctrine.

II

THE DISTRICT COURT DID NOT ERR IN ITS APPLICATION OF THE DOCTRINE OF ABSTENTION

It is becoming more common for a defendant in state obscenity cases, or, this case, a party related to a defendant, to seek injunctive and declaratory in the federal courts. When seeking to enjoin the state proceedings and harged matter declared not obscene the moving party invariably asserts s action is not vulnerable to the application of the Doctrine of Abstention. gument is made by appellant herein that such an action when sought under vil Rights Act pursuant to alleged deprivations of a constitutional right, s the principle of abstention inapplicable. The cases indicate, of course, is is just not true.

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[3] "28 U.S.C. 2283 Stay of State Court Proceedings

A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments. June 25, 1958, c. 646, 62 Stat. 968."

A. THE DISTRICT COURT DID NOT ERR IN ITS APPLICATION OF THE DO TRINE OF ABSTENTION BECAUSE THE STATE COURTS HAVE PROVID AND CONTINUE TO PROVIDE, AN AVAILABLE FORUM BEFORE WHIC APPELLANT CAN PRESENT FOR RESOLUTION EVERY ISSUE OF FAC AND LAW THAT HE SEEKS TO PRESENT BEFORE THE FEDERAL COU

In an obscenity case, as in any other case, the court must face the absten question. It has been held that the Doctrine of Abstention forecloses a hearing decision on the factual merits of the obscenity issue. Outdoor American Corp. v Philadelphia (1964 3rd Cir.) 333 F.2d 963 rehearing denied, Certiorari denied 379 U.S. 903, and Dale Book Company v. Leary (1964) 233 F. Supp. 754.

In the Outdoor American case local retailers were arrested by Philadelpi authorities for selling obscene publications. The publisher who supplied the d- tributors and retailers with the allegedly obscene materials then sued under th Civil Rights Act in the District Court for a declaratory judgment and for injun iv relief. The publisher also joined as plaintiff one of the distributor/retailers i- volved in the criminal proceedings. Upon defendants' motion the District Cou dismissed the complaint on the ground that interference in state proceedings vas not justified. On appeal to the United States Supreme Court the dismissal was left undisturbed.

The Outdoor American case is a perfect example of the established prinip of the Doctrine of Abstention being followed in an obscenity case. The federa courts never considered hearing the obscenity issue. The rule is succinctly sat by the court on appeal:

> "(1) Plaintiffs' prayer for a declaration the publications in question were not obscene is a circuitous way of requesting the district court 'to interfere with or embarrass' state proceedings. Whether the court should abstain from passing upon the merits of this litigation,

leaving that decision to the state courts, is the crucial question raised by the request for a declaratory judgment. No reason for the district court to involve itself with the basic question of obscenity at this time exists. The decision of the state courts may result in plaintiffs' obtaining the objectives they now seek. If not, petition to the Supreme Court of the United States for writ of certiorari remains. As Mr. Chief Justice Stone for the Supreme Court in Douglas v. City of Jeannette, 319 U. S. 157, 163, 63 S. Ct. 877, 881, 87 L Ed. 1324 (1943) stated:

> 'Congress, by its legislation, has adopted the policy, with certain well defined statutory exceptions, of leaving generally to the state courts the trial of criminal cases arising under state laws, subject to review by this Court of any federal questions involved. Hence, courts of equity in the exercise of their discretionary powers should conform to this policy by refusing to interfere with or embarrass threatened proceedings in state courts save in those exceptional cases which call for the interposition of a court of equity to prevent irreparable injury which is clear and imminent; and equitable remedies infringing this independence of the states--though they might otherwise be given--should be withheld if sought on slight or inconsequential grounds.' " (at page 965)

The application of the Outdoor American ruling was swift. The United District Court for the Eastern District of Pennsylvania relied on the prin- efined in Outdoor American when deciding Dale Book Company v. Leary. [4]

The facts in the Dale case were identical to those now before this A local dealer of nudist magazines was arrested by city authorities for obscene materials. The wholesale distributor, who did business with al retailer, thereafter brought an action against the city officials injunction under the Civil Rights Act to restrain prosecution dings. The court first exhausted the abstention issue which it felt lispositive, and then, out of an overabundance of caution, it discussed

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3 F. Supp. 754

the obscenity issue.

> "To this Court it appears that there is a further question: is this a matter in which a federal court should intervene at this stage in any event? This question, which is usually called the Doctrine of Abstention, in the opinion of this court, seems to foreclose, in any event, a decision on the merits of the publications." (at page 757)

The court's ruling on the abstention issue read as follows:

> "5. A federal court, in the exercise of its discretion, will not interfere in pending state proceedings on the assumption that a Pennsylvania statute will be interpreted unconsitutionally.
>
> "Accordingly, in the exercise of its discretion, this court will abstain from granting a preliminary injunction and granting other relief sought by the plaintiff in view of pending Pennslyvania criminal proceedings involving the subject matter of this suit." (at page 763)

The above cases clearly indicate that obscenity cases in which First Amendment issues are raised are in no way immune from the time-honored rationale of the Doctrine of Abstention.

The appellant states that the thrust of his complaint herein is directed against the censorship which appellees have invoked. (Appellant's Brief, page 16). Actually, there was no "censorship" of "The Complete Marquis de Sade" as the appellant has used this term. "Censorship," as it is used in this context, implies the use of threats of prosecution to keep the materials from being distributed. In this case, no threats of prosecution were ever made. Rather, there was a good-faith prosecution of materials believed to be obscene under the standards by which obscenity is judged. The Defendants' Proposed Findings of Fact filed in the Federal District Court stated the point exactly:

> "Neither the defendants nor any other officials or employees of The

City of San Diego have threatened, ordered, warned, or instructed plaintiff, or any news dealers selling plaintiff's materials, to refrain from selling Sade. At no time have the defendants threatened plaintiff with criminal prosecution by reason of the sale or continued production or distribution of Sade." (Proposed Finding of Fact #14)

Appellant cites the case of Zwickler v. Koota (1967) 389 U.S. 241 [88 S. Ct. [19 L Ed. 2d 444] to support his proposition that abstention is improper here. Zwickler case, however, is easily distinguishable on its facts from the case re this court. In Zwickler, a state statute made it a crime to distribute hand- in an election anonymously. An accused individual was convicted of violating statute, but obtained a reversal on state law grounds. After the state proceed- had completely terminated, and when threatened state prosecution under the e statute continued, the defendant instituted an action in the federal district t. The defendant sought declaratory and injunctive relief under the Civil ts Act based on the ground that the state statute was invalid on its face under First Amendment. At the time the federal court action was instituted, there no other forum in which the question was pending nor where a hearing could ad on the constitutional issue. These facts comprise the common thread to ound woven throughout all those cases cited by appellant in his brief on pages nd 19. Given such facts the courts, not surprisingly, have found abstention e inappropriate. Where a party is given no opportunity to test a statute al- dly unconstitutional on its face, then the federal courts will provide the forum redress.

In the case at bar, however, there is a statute the constitutionality of which not been challenged and the terms of which are fairly subject to interpretation

in the state courts. In the very case relied upon by appellant, Zwickler v. Koot it is indicated that under those circumstances where a state court hearing would avoid or modify the constitutional issues sought to be presented before the feder court, the federal court should abstain. [5] This is the very essence of the case before this court. A convenient and available forum for the trial of the issues i this case has in fact already been provided. One of the cases in the state court progressed to such a point that the retrial of the same issues in the federal cou would constitute a useless act.

In an attempt to further substantiate his argument that abstention is not a- propriate in this case appellant cites and relies on Corsican Productions v. Pr (1964) 338 F. 2d 441. In that case, the appellants' complaint, seeking a restrai order and damages, was brought under the Civil Rights Act. The complaint al leged that appellants' movie, "Bachelor Tom Peeping", was not obscene and th appellees, deliberately intending to suppress the film, threatened exhibitors wh prosecution if they showed the film. Such a case is easily distinguished from he case at bar. The court, in fact, provided the distinction in its very holding by stating that in Corsican there were only threats of prosecution with the purpos of suppressing the film. Compare such threats to the good-faith prosecution i th present case. Not only has the forum for a resolution of the issues been avai- able to the appellant in this case, but he has taken advantage of that forum. Ap- pellant's attorneys have already spent four weeks in trial in the San Diego Mui- cipal Court presenting the same issues of fact and law that they propose to

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5. Zwickler v. Koota, 389 U.S. 241 [19 L. Ed. 2d 44, at 450]

sent to the federal courts. Clearly, the principle of the Corsican case is plicable to the facts now before this court. [6]

The state proceedings, especially the pending appeal, provide the quickest sible final determination of the obscenity of "The Complete Marquis de Sade." material involved in the Municipal Court and Superior Court Appellate Dement proceedings is identical to that offered by appellant to the federal rts for a determination of the obscenity question. The same questions of fact law arise in both cases and the same attorneys are handling all cases. A ring on the substantive question of obscenity by this court would only result in usurpation or duplication of the prosecution of "The Complete Marquis de Sade" in progress in the state courts. There is no basis for believing that the state rts have been, or will be, unable to properly interpret and apply the laws of State of California. Appellant's request for a determination on the issue of enity constitutes a request of the federal courts to interfere with or embar- the state proceedings. This court should not hesitate to concur in the denial uch a request.

Appellant argues on page 21 of his opening brief that the Doctrine of Absention as defined in the Douglas case has been held by this court in the Corsican case to be inapplicable "under the circumstances presented by the facts and pleadings". He tries to imply that the "facts and pleadings" referred to are those presented in this case. Such a statement is plainly wrong. The Corsican rule obviously applies to the facts and pleadings of that case alone and not to the case before this court which differs crucially from Corsican.

B. THE DISTRICT COURT DID NOT ERR IN ITS APPLICATION OF THE DOCTRINE OF ABSTENTION BECAUSE APPELLANT HAS NOT SHOWN DANGE OF IRREPARABLE INJURY BOTH CLEAR AND IMMINENT FOR WHICH HE HAS NO LEGAL REMEDY.

The argument has been made by the appellant that because a retailer is arrested for selling allegedly obscene material. the publisher of said material is thereby subjected to irreparable injury, that incident to the retailer's arrest he suffered damage. The argument has taken the following form; the retailer is afra to do further business with the publisher because of the alleged possibility of continued arrests, thereby causing the publisher some financial disadvantage. and th publisher has suffered injury to his business reputation by reason of the arrest. The courts have definitely not been impressed with the irreparable nature of such injuries as contemplated by the law.

Justice Stone pointed the way when he ruled in Douglas that an injunction would not be granted save in those circumstances where irreparable injury, which is both clear and imminent cannot otherwise be avoided. If irreparable injury cannot be shown, or it can be avoided by means other than injunctive relief, then the Doctrine of Abstention will be applied. This criterion has been applied in cases having facts identical to those before this court.

At page 21 of his brief appellant declares that respondents' reliance on the Outdoor American case is "obviously misplaced." He argues that the principle of the case is inapplicable here because one of the Outdoor American plaintiffs in

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7. Respondents emphasize that these assertions are nothing more than argument. No evidence to indicate the genuineness of the statements has been offered. References by appellant at page 5 of appellant's opening brief are to unproved allegations in appellant's complaint.

the federal action for injunctive and declaratory relief was also a defendant retailer in the state criminal prosecutions. Appellant argues that in this case, because the defendants in the criminal action are not parties to the federal suit, a resolution of the state actions will not afford the appellant the relief he seeks. Appellant's argument is specious.

As in the case before this court, the publisher in the Outdoor American case who was the plaintiff in the federal suit seeking declaratory and injunctive relief, was in no way involved in the state criminal proceedings. One of the several retailers who had been arrested for selling allegedly obscene materials, which materials were supplied by the plaintiff, was also a party plaintiff in the federal suit. At the District Court and Court of Appeals levels the publisher argued that any resolution of the state criminal proceedings involving the retailer would offer no protection for him. This is the identical argument posed by appellant herein. Just as in the Outdoor American case, the appellant herein alleges irreparable damage caused by the state action and the lack of an available forum for the redress of his injuries. The court in the Outdoor American case handled this argument as follows:

> "Danger of irreparable injury both 'clear and imminent' has not been shown. Since there are three plaintiffs in the matter before the federal court and only one involved in state proceedings, it is argued a finding of not guilty in the state courts of one of the plaintiffs is no protection to the others. The fact only one plaintiff is being prosecuted in the state courts is without independent legal significance, since publications involved are the same as to each plaintiff. All issues plaintiffs are raising in the federal court may be brought before the state courts, and there is no reason to believe state officials will enforce the Pennsylvania statute against plaintiffs not involved in state proceedings if the publications are found not obscene in the pending criminal prosecution. If held obscene,

> plaintiffs not involved in state proceedings cannot complain of enforcement of the statutes. Nor should a federal court of equity ambush the state courts by deciding the fundamental basis of obscenity." (at page 965)

So, merely because the plaintiff may not be a party defendant in the pending state action does not mean that he is injured irreparably and is without an adequate remedy.

The application of the irreparable injury principle set forth in the Outdoor American case can again be witnessed in Dale Book Co. v. Leary.[8] Where a newsdealer was arrested for distributing obscene materials, the distributor sued in the federal court to enjoin the state action. The facts and the claims made by the plaintiff were, once again, identical to those presented to this court.

> "There was no evidence of prior threats, warnings or other orders relative to these arrests and seizures. Indeed, the testimony was entirely to the contrary as to the assertion of prior restraint, (citations omitted) as appears in the specific finding which follows:
>
> "No officer of plaintiff was arrested for possessing or disseminating the nudist publications for which it is the distributor in this area. No nudist publications were seized from plaintiff. Indeed, no official action has ever been directed against plaintiff to prevent distribution of nudist publications. The arrest of Dale customers, the newsdealers mentioned above, have indirectly affected Dale in two ways. First, the dealers in Philadelphia are apparently afraid to buy Dale publications for fear of being arrested for violation of the Pennsylvania Obscenity Statute. Secondly, Dale is obligated by trade custom and practice to give the arrested dealers a credit for those magazines distributed by Dale which were seized on the three occasions already described." (at page 756)

When faced with these facts the court found, at page 763, that "Inconvenience and possible financial loss is no ground for federal intervention, in the absence of a showing of irreparable injury not compensable in money damages."

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8. 233 F. Supp. 754

The facts in the case here reveal that the appellant has not been injured, or threatened with injury, other than that incidental to the enforcement of state law. It would be a truly intolerable situation if, whenever an individual is charged with a criminal offense anyone having a business relationship with that individual could contest the charge in an original proceeding in a federal court. As an incident to nearly every lawful arrest, a defendant or someone related to the defendant suffers some consequential financial injury. Because the law does not contemplate or sanction the hearing of such cases the rule has evolved that injuries suffered as the result of a lawful arrest are not irreparable and do not enable a party injunctive relief in a federal court.

III

THE DISTRICT COURT DID NOT ERR IN ITS APPLICATION OF THE DOCTRINE OF ABSTENTION BECAUSE THE SUBSTANCE OF APPELLANT'S SUIT FOR DECLARATORY AND INJUNCTIVE RELIEF CONSTITUTES A REQUEST OF THE FEDERAL COURTS TO STAY OR IMPEDE STATE PROCEEDINGS.

It is never set forth in appellant's pleadings that he seeks to actually enjoin the pending state proceedings. He declares that he has been "threatened" with irreparable injury by the "conduct" of respondents, which "conduct" he seeks to have terminated by this court. The only "conduct" of the respondents which indirectly affected appellant has been the arrest, prosecution, and conviction of local booksellers. There cannot be one shred of doubt that it is this process that appellant wishes to impede.

The law requires that the court, when considering injunctive relief, contemplate the actual impact of its ruling rather than its mere form. Sperry Rand

Corp. v. Rothlein (1961) 288 F. 2d 245. Even where a plaintiff does not ask for an injunction to stay or impair state proceedings, where it is apparent that this, in effect, is his object, his request will be denied. McGuire v. Amrein, 101 F. Supp. 414. Nor is the prohibition regarding the enjoining of state proceedings avoided by framing an injunction as a restraint on a party litigant rather than directly against the state court itself. H. J. Heinz Co. v. Owens, 189 F.2d 505 [342 U.S. 905] [96 L. Ed. 677]; Chaffee v. Johnson (1964) 229 F. Supp. 445, affirm 352 F.2d 514, certiorari denied 384 U.S. 956. While not so stated specifically, appellant seeks to enjoin state proceedings. That could be the only possible explanation for this action. The thinly-veiled attempt at a restraint upon the state court was recognized by the District Court for what it was and the attempt was repulsed. Respondents respectfully submit that this court should affirm this conclusion.

IV

THE DISTRICT COURT DID NOT ERR IN NOT HEARING THE OBSCENITY ISSUE AND GRANTING RESPONDENTS' MOTION FOR SUMMARY JUDGMENT BECAUSE THE SUBSTANTIVE QUESTION OF OBSCENITY WAS NOT BEFORE THE COURT.

The decision of the District Court to grant respondents' Motion for Summar Judgment necessarily precluded a hearing on the question of obscenity. Respondents grounded their motion on the application of the Doctrine of Abstention. The granting of said motion forestalled the presentation of the substantive issue entirely.

The court had no evidence before it to provide a basis for deciding the obscenity issue. The unproved allegations contained in appellant's pleadings provided

the court with nothing upon which judgment could be based.

Respondents have never asserted, and do not assert here, that triable issues of fact do not exist in the process of determining the obscenity of "The Complete Marquis de Sade." Where a party asserts, as appellant does here, that charged matter has some redeeming social importance by virtue of its being the entire antiquated work of a writer who has illuminated the extremes of human thought and conduct, there could not exist a more basic question of fact than the genuineness of that assertion. The question of whether or not "The Complete Marquis de Sade" is utterly without redeeming social importance cannot be determined without a full hearing designed to disclose facts bearing on this point.

It is the respondents' position that those factual issues should be tried, as they indeed have been in one case, in the state courts. In the event that this court disagrees with the application of the Doctrine of Abstention respondents submit that its only choice would be to remand the cause to the District Court for trial.

CONCLUSION

From the above review of the facts and the law the merit of respondents' position is clear. The District Court did not err by applying the Doctrine of Abstention and granting respondents' Motion for Summary Judgment. It is respectfully submitted that the judgment of the District Court should be affirmed.

Respectfully submitted,

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By /s/ KENNETH H. LOUNSBERY, Depu

Attorneys for Respondent.

CERTIFICATION

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with tho Rules.

/s/ KENNETH H. LOUNSBERY, Deputy

NO. 22361

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

HOLLOWAY HOUSE PUBLISHING CO.,
a California corporation,

Appellant,

vs.

WESLEY S. SHARP, individually, and as Chief of Police of the City of San Diego, and EDWARD T. BUTLER, Individually, and as City Attorney for the City of San Diego,

Appellees.

APPELLANT'S REPLY BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

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Appellees.

APPELLANT'S REPLY BRIEF

STATEMENT

The principal thrust of Respondents' Brief is "abstention". Respondents do not dispute that the complaint states a claim upon which relief could be granted by a federal District Court. There is no denial of the jurisdiction of the District Court to entertain the claim for declaratory and injunctive relief under governing federal statutes. Indeed, the respondents concede that, absent the issue of abstention, triable issues of fact were presented which precluded the grant of the motion for summary judgment in

favor of respondents, dismissing the complaint. Indeed, respondents conclude the brief with the statement that if "this Court disagrees with the application of the Doctrine of Abstention", then the "only choice would be to remand the cause to the District Court for trial" (Resp. Br. 17).

ARGUMENT

I

THE DISTRICT COURT HAD THE DUTY TO DECIDE THE APPROPRIATENESS AND THE MERITS OF THE REQUEST OF APPELLANT FOR DECLARATORY AND INJUNCTIVE RELIEF. IT WAS ERROR TO APPLY THE DOCTRINE OF ABSTENTION AND TO DISMISS APPELLANT'S COMPLAINT. (Replying to Resp. Arg. 3-16).

I. Respondents state that a federal court, faced with a petition to grant injunctive relief where a state proceeding is pending, "must initially consider the possible application of the Doctrine of Abstention" (Resp. Br. 3).

The aforesaid statement is based on two incorrect premises. In the first place, given a proper invocation of federal jurisdiction conferred by Congress and the Constitution, the doctrine of abstention is not an "initial consideration", but a principle to be invoked only in the last resort in very narrowly limited "special circumstances". Zwickler v. Koota, 389 U.S. 241, 88 S. Ct. 391, 395, 19 L. Ed. 2d 444. In the second place, this was not a petition to grant injunctive relief against some

pending state proceeding. The relief sought here is declaratory relief and injunction against individual law enforcement officials engaging in unlawful conduct. The appellant did not seek to enjoin any state proceeding. See Zwickler v. Koota, 389 U.S. 241, 88 S. Ct. 391, 395, 19 L. Ed. 2d 444. See also Corsican Productions v. Pitchess, 338 F. 2d 441 (9 Cir. 1964). See also R. T. 8-9. [1]

The decisions in Douglas v. City of Jeannette and Stefanelli v. Minard, relied upon by respondents (Resp. Br. 4-5), are not relevant to the issues presented in these proceedings. See, Appellant's Opening Brief 14-20. See, the recent decisions of the United States Supreme Court in Damico v. California, 88 S. Ct. 526 (Dec. 18, 1967) and Sweetbriar Institute v. Button, 387 U.S. 423, 87 S. Ct. 1710, 18 L. Ed. 2d 865. See also, on remand, Sweetbriar Institute v. Button, 280 F. Supp. 312 (D. C. Va. 1967), permanent injunction granted.

For similar reasons, reliance by respondents upon Title 28, United States Code §2283 (Resp. Br. 5 n. 3) is also misplaced. This is not an action to stay proceedings in a state court. The complaint seeks only a declaration that respondents are engaging in conduct in violation of federal laws and the federal Constitution, and for injunctive relief against such unlawful conduct by the individual respondents acting under color of law. See, Drombrowski v. Pfister, 380 U.S. 479, 85 S. Ct. 1116, 1119 n. 2.

II-A. The respondents continually attempt to avoid the

1/ The reference "R. T." is to the Reporter's Transcript of proceedings on the hearing of the motions for summary judgment.

nature and character of the proceedings instituted by appellant in the federal court. The complaint was directed against the conduct of respondents in threatening to immediately and continuously prosecute retail owners in San Diego who sought to enter into business relations with appellant, the publisher of The Complete Marquis de Sade. The principal thrust of the complaint was that respondents threatened to continue in their unlawful conduct so as to permanently exclude the publications from sale and distribution in the City of San Diego. The prayer of the complaint, was, among other things, for declaratory relief with respect to such threatened conduct and for injunctive relief solely against respondents' threats, or other acts or practices, which interfere with the sale or distribution of the publication in the City of San Diego (App. Br. 3-6).

It is difficult for the respondents to deny that the appellant stated a claim for relief under the laws of the United States and the Constitution. That declaratory and injunctive relief may be obtained in a federal court against law enforcement officers attempting to impose an "informal censorship" is well established (App. Br. 16-17). Indeed, respondents decline to meet this issue by asserting that if "censorship" is to be equated with "threats of prosecution", then no censorship is involved because respondents are not threatening prosecution (Resp. Br. 8). Such an assertion is baseless under the circumstances of the record here presented.

In the first place, the respondents candidly concede that

they have arrested various retail bookstore owners who sold the publication and charged them with violations of the state obscenity law; and respondents concede that a total of nine defendants are involved in those arrests (Resp. Br. 1-2). Clearly, the threats of further prosecutions of all retailers who seek to purchase the book from appellant in San Diego are implicit in the very concessions made by respondents. "And there comes a point where this Court should not be ignorant as judges of what we know as men." Watts v. Indiana, 338 U. S. 49, 69 S. Ct. 1347, 1349, 93 L. Ed. 1801.

In the second place, the respondents are in error in relying upon certain of their own "proposed findings of fact" with respect to the issue of threatened prosecutions (Resp. Br. 8-9). These findings were not signed by the court below. Indeed, on this very issue the court below stated to counsel for respondents:

> "THE COURT: I don't see much difference, Counsel, between a threat and prosecution. I mean there isn't -- you can't distinguish between the two." (R. T. 25).

In the third place, respondents disregard the admonition contained in Zwickler v. Koota, 389 U. S. 241, 88 S. Ct. 391, 19 L. Ed. 2d 444. A request for a declaratory judgment must be considered separate and apart from the prayer for injunctive relief. The mere fact that there is a request for injunctive relief does not create a "special circumstance" justifying the

doctrine of abstention. It is enough that the complaint and supporting papers set forth a cause of action against the attempt by respondents to impose a censorship in the City of San Diego upon appellant's publication. In this respect alone, appellant was clearly entitled to declaratory and injunctive relief, and under Zwickler it was error to deprive appellant of his access to a federal court to vindicate a federal right conferred upon him by the Congress of the United States and the Constitution. It is only when it appears that a plaintiff can prove no set of facts in support of his claim which would entitle him to relief that a complaint under the Civil Rights Act may be dismissed. Conley v. Gibson, 355 U.S. 41, 78 S. Ct. 99, 2 L. Ed. 2d 80; York v. Story, 324 F. 2d 450 (9 Cir. 1963).

The respondents attempt to distinguish Zwickler v. Koota on untenable grounds. Respondents assert that the state proceedings in Zwickler had been completely terminated, and when threatened state prosecution under the same statute continued, the defendant in that case instituted an action in the federal district court. Respondents then argue that in such a case there "was no other forum in which the question was pending nor where a hearing could be had on the constitutional issue" (Resp. Br. 9).

However, it should be observed that the three judge court in Zwickler, which applied the doctrine of abstention upon the ground that the appellant in that case could assert his constitutional challenge in defense of any criminal prosecution for any future violation of the statute, or bring an action in the state court

for declaratory judgment, was reversed by the United States Supreme Court. In Zwickler, appellant was attempting to enjoin a criminal prosecution, albeit a future prosecution, and was seeking relief against an action which was remote in time and dependent upon his own violation of the law. Yet, despite all this, the Supreme Court held that Zwickler was entitled to maintain his claim in the federal court for declaratory and injunctive relief. In the case herein, appellant is not seeking to enjoin any criminal prosecution, and the unlawful conduct of respondents in seeking to impose a censorship in the entire City of San Diego, with respect to The Complete Marquis de Sade, is a present and continuing threat. Zwickler, therefore, cannot be distinguished in respondent's favor, but, on the contrary, is very much opposed to its position.

The attempt to distinguish Corsican Productions v. Pitchess, 338 F. 2d 441 (9 Cir. 1964) is also fruitless (Resp. Br. 10-11). The sole basis of the distinction appears to be that in Corsican there were allegedly only threats of prosecution "with the purpose of suppressing the film" (Resp. Br. 10), while here it is asserted there has only been good faith prosecution. But, it is perfectly clear and conceded by respondents, and understood by the court below, that the continued prosecutions of every retail dealer in San Diego by respondents is a deliberate attempt to suppress The Complete Marquis de Sade; and this unlawful attempt under the laws and Constitution of the United States is the essence of the publisher's complaint, appellant here. Corsican Productions,

therefore, is clearly supportive of appellant's position.

Respondents reiterate their reliance upon the decisions in the Third Circuit; but, as pointed out in Appellant's Opening Brief, this is not a case which attempts to enjoin criminal prosecutions; the decisions are not in accord with Corsican Productions and were decided before the ruling by the United States Supreme Court in Zwickler v. Koota, 389 U. S. 241, 88 S. Ct. 391, 19 L. Ed. 2d 444.

II-B. The respondents argue that appellant has not shown a danger of irreparable injury for which he has no legal remedy (Resp. Br. 12-15). Respondents do not seriously contend that the appellant will not suffer great loss and damage to its standing, reputation, prestige, business and good will by reason of the conduct of respondents; and that the conduct of respondents, if continued, will result in a continued financial loss to appellant, as well as a deprivation of the right of the people of the City of San Diego to read the publication involved.

The gist of respondents' argument here appears to be that appellant's injury is not irreparable because "the same questions of fact and law" (Resp. Br. 11) are involved in the state court criminal prosecutions against the retailers in San Diego, and thus appellant's rights will be adequately protected (Resp. Br. 11, 12-15).

This position is erroneous for two reasons. In the first place, the conduct of respondents, which is the subject matter

of the prosecution in the federal courts involving, as it does, issues of censorship over books in the City of San Diego, is not a definitive issue in the state court criminal prosecutions against the retailers under the state obscenity law. In the second place, it is not correct to state that the state court criminal prosecutions will necessarily resolve the issues involved herein. Just as in Zwickler, for example, it is possible for a reversal of the conviction of the retailers to which respondents refer to be based upon state law grounds; and, in such case, there may be protracted subsequent litigation without any decisive result. With respect to the retailers who are being prosecuted in the state court proceedings, the failure of proof of scienter may be dispositive of all the criminal cases without resolving the basic issues relative to the constitutional protection of the publication itself. In the meantime, the conduct of respondents may continue unabated, and a book which is entitled to constitutional protection will be suppressed in violation of the guarantees of the free speech and press provisions of the Constitution. Freedman v. Maryland, 380 U.S. 51, 85 S. Ct. 734, 13 L. Ed. 2d 649.

The respondents' arguments with respect to alleged lack of "irreparable injury" were implicitly rejected in Zwickler v. Koota and in Corsican Productions. See also, cases cited in Appellant's Opening Brief, pp. 16-17.

III. Respondents' attempt to fit the proceedings here into the mold of an action to "enjoin the pending state proceedings"

(Resp. Br. 15) is without support in this record or in the law. The cases cited by respondents do not support its position and, rightly considered, are opposed to its position. This is not an action to enjoin the use or misappropriation of trade secrets in a state court; or an action by an accused to enjoin the use of intercepted telephone conversations in a state criminal prosecution; or an action seeking an injunction to restrain a party from pursuing contempt proceedings in a state court; or an action to enjoin officials from prosecuting a plaintiff for perjury in a state court.

This is an action directed against the censorship imposed by respondents in the City of San Diego with respect to the publication The Complete Marquis de Sade. The appellant is not seeking to enjoin any state criminal prosecutions. The relief sought is a declaration that respondents are engaged in conduct which constitutes a previous restraint on the circulation of a publication and the suppression of that publication, and that respondents be enjoined from such unlawful conduct.

IV. Absent the issue of "abstention", the respondents do not deny that the order of the court below, granting respondents' motion for summary judgment and dismissing the complaint, was clear error. The respondents concede that "triable issues of fact" do exist. Respondents state that with respect to the issue of "social importance" there could not exist a "a more basic question of fact" than the genuineness of that assertion. It is

avowed that the issue "cannot be determined without a full hearing designed to disclose facts bearing on this point" (Resp. Br. 17).

Thus, respondents conclude that, if "this court disagrees with the application of the Doctrine of Abstention", then the "only choice would be to remand the cause to the District Court for trial" (Resp. Br. 17). Respondents fail to add, even on their own terms, with respect to abstention, that "it is better practice, in a case raising a federal constitutional or statutory claim, to retain jurisdiction, rather than to dismiss" (Zwickler v. Koota, 88 S. Ct. at 393, n. 4).

CONCLUSION

As respondents' arguments themselves make clear, the District Court erred in granting respondents' motion for summary judgment and dismissing the complaint. The order and judgment of the District Court should be reversed.

Respectfully submitted,
STANLEY FLEISHMAN and
GOSTIN & KATZ
By: STANLEY FLEISHMAN
Attorneys for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Stanley Fleishman
STANLEY FLEISHMAN

No. 22364

In the

United States Court of Appeals

For the Ninth Circuit

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellant,

vs.

OLYMPIA BREWING CO.,
a corporation,

Appellee.

On Appeal from the United States District Court
for the Northern District of California

Brief for Appellant

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On Appeal from the United States District Court
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Brief for Appellant

JURISDICTIONAL STATEMENT

This is an appeal from a judgment entered on October 3, 1967, by the United States District Court for the Northern District of California, denying in part the appellant's application for a preliminary injunction pending trial (R. 294). The underlying action was brought under the antitrust laws of the United States (15 U.S.C. §§ 1, 2) for declaratory and injunctive relief, plus treble damages, by reason of appellee's anticompetitive conduct in institution of a wholesale fair trade program directed at appellant, followed by appellee's refusal to deal with appellant. The District Court's jurisdic-

tion was invoked under 28 U.S.C. § 1337 (R. 1, 37, 90). The District Court's judgment of October 3, 1967, ordered the issuance of a preliminary injunction enjoining defendant's refusal to deal, but only up to a fixed maximum quantity, and denied the application for an injunction enjoining appellee's enforcement of wholesale fair trade price restrictions upon appellant (R. 294, 154). The appellant filed a timely Notice of Appeal under 28 U.S.C. § 1291 on October 10, 1967 (R. 263), and this Court's appellate jurisdiction rests upon 28 U.S.C. § 1291. Defendant has taken a cross-appeal from the injunction against its refusal to deal (R. 285).

STATEMENT OF THE CASE

This is a suit brought under the Sherman Act by Beverage Distributors, Inc. (BDI), a California corporation engaged in the wholesale distribution of beer and wine products, including Olympia beer, against Olympia Brewing Co. (Olympia), a beer manufacturer, for injunction, declaratory relief and damages. BDI sought a preliminary injunction against enforcement of Olympia's wholesale fair trade program and against Olympia's subsequent refusal to deal with BDI. At the time of this cut-off, BDI's sales of Olympia products represented 25% of its beer business (R. 63). Olympia has conceded that it entered into the fair trade program and then refused to deal with BDI for the purpose of preventing BDI from competing for sale of Olympia products to those of its retail customers which had theretofore purchased Olympia beer from Olympia's other wholesalers (*infra* at 8-10). The fair trading and refusal to deal were both means used by Olympia to enforce territorial and customer restrictions agreed upon between Olympia and its other California beer wholesalers, in per se violation of the Sherman Act as held in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1246 (1967)

(*infra* at 11-13). The District Court enjoined Olympia's refusal to deal, and BDI now appeals from denial of a preliminary injunction against enforcement of the fair trade program, which was admittedly entered into for the same purpose (*infra* at 6-8).

For over fifteen years BDI has distributed Olympia products in California (R. 63). Unlike some other Brewers whose products BDI handles, Olympia has a system of territorial and customer restrictions which—as applied to BDI—required BDI to limit its sale of Olympia products to Safeway Stores, Incorporated (R. 63, 70). BDI operates differently than almost all other beer distributors in California in that it delivers to retailers' central warehouses, rather than to individual stores (R. 63, 64). As the result of the efficiencies and limited-service nature of this method of competition, BDI is able to sell Olympia products at prices approximately 36¢ a case lower than do Olympia's other distributors in California (R. 65). None of them, other than BDI, sells below prices which Olympia has "suggested" over the years (R. 65).

In August 1967, following the decision of the Supreme Court in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1246 (1967), BDI served notice that it would no longer abide by Olympia's customer and territorial restrictions, and that it would compete by offering Olympia products to its other central warehouse customers (R. 64, 74). Upon receipt of BDI's letter, and because of BDI's intention to compete for the Olympia business of these other customers, Olympia immediately entered into fair trade contracts specifying minimum prices 36¢ per case higher than BDI's for wholesale sales in California (R. 64, 77; Plaintiff's Exhibit 3, excerpts from depositions of Phil Hannah, Olympia sales director, and Robert Schmidt, Olympia president, pages 15-19). For two or three weeks

BDI was unable to make any sales for its central warehouse distribution at the "fair trade" prices. However, eventually BDI did succeed in making a few sales at these prices and so placed further orders with Olympia (R. 65; Plaintiff's Exhibit 3, excerpt from deposition of Thomas Morgan, Olympia vice president, page 22). Upon receipt of these orders, Olympia notified BDI that it would no longer sell to BDI at all (R. 65, 83; Plaintiff's Exhibit 3, excerpts from depositions of Olympia executives Thomas Morgan, Phil Hannah and Robert Schmidt, pages 22-5).

1. Olympia's illegal exclusive distributorship territories and customer restrictions.

Over the years Olympia has carefully maintained a system of exclusive distributorship territories and customer restrictions designed to and having the effect of successfully preventing competition between its wholesale distributors. By Olympia's own admission, these territories are "well-defined geographical areas which are not overlapping" (affidavit of Thomas Morgan, Olympia vice president, confirmed by Phil Hannah, Olympia sales director, quoted at R. 43), and the territories have for some time been particularly described in maps and schedules kept within Olympia's custody (Plaintiff's Exhibits 1 and 2; testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, page 3). Olympia's sales director can only recall two occasions within recent years on which more than one Olympia distributor attempted to compete for sales to the same customer (Hannah deposition, Plaintiff's Exhibit 4, pages 16-29). On those occasions Olympia was promptly notified of the incident by its field personnel, and, in each instance, by personal intervention in the territorial disputes, was able to persuade the distributors involved that competition between them was

"economic idiocy" (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 4-6; Hannah deposition, Plaintiff's Exhibit 4, pages 26-8). Those conflicts were quickly resolved by agreements dividing up the disputed accounts, and even after the filing of this action, Olympia's president admitted that Olympia had never considered abandoning or otherwise modifying its territorial system (testimony of Robert Schmidt, in Plaintiff's Exhibit 3, pages 3-4).

At no time during the hearing on preliminary injunction did Olympia present any evidence conflicting with its earlier admission that, with minor exceptions, it operates in California through a system of exclusive geographical territories. The District Court's own comments, after consideration of the evidence outlined above, indicate no doubt that Olympia was found to operate under such a system (R.T., pages 49-54, 57), and the finding of reasonable probability that such is true is set forth in the temporary restraining order which was continued in effect as the Court's preliminary injunction order (R. 152).

Because of such territorial and customer restrictions, BDI is the only beer distributor in California which has distributed Olympia products to customers' central warehouses at the lower prices permitted by that more efficient method of distribution. The result of Olympia's territorial and customer restrictions has been, therefore, to eliminate completely any price or service competition among its other wholesale distributors (R. 63-5; excerpts from Hannah deposition, Plaintiff's Exhibit 3, pages 4-6).

2. Efforts of Olympia's other distributors to obtain Olympia's agreement to refuse to deal with BDI.

Olympia's September 1967 decision to refuse to make further sales to BDI was the culmination of constant efforts

by other Olympia distributors over the years. These store-door distributors refused to engage in the central warehouse type distribution which would enable them to compete in price with BDI (R. 199). Rather, they and other distributors have for years attempted to destroy BDI. From time to time Olympia's president and Mr. Hannah, sales director, would discuss terminating BDI after Mr. Hannah would "catch hell" from a distributor for continuing to sell to BDI (excerpt from Schmidt deposition, quoted in Plaintiff's Exhibit 3, page 7). Olympia's distributors regularly brought up the subject in meetings with brewery officials (excerpt from Hannah deposition, quoted in Plaintiff's Exhibit 3, pages 8-9). BDI, according to Mr. Hannah, was "not going to win any popularity contests" (*id* at 10). Distributors resented the fact that BDI's sales of Olympia products to Safeway's central warehouse resulted in eventual distribution to Safeway stores within their exclusive territories (*ibid.*). This distribution to Safeway was an exception to the exclusive territorial arrangements which was bitterly resented (*id.* at 11-13).

3. Olympia instituted its wholesale fair trade program for the purpose of preventing BDI from competing for sales to customers illegally assigned by Olympia to other distributors.

On August 7, 1967, shortly after the United States Supreme Court's decision in *United States v. Arnold, Schwinn & Co.* made clear that BDI would be in violation of law if it were to acquiesce in Olympia's resale restrictions, BDI gave written and oral notice to Olympia of BDI's intention to compete with its low-cost method of distribution for the Olympia business of those of BDI's other customers having central warehouses and desiring to purchase from BDI (R. 64). Four days later, BDI was notified by Olympia that Olympia had instituted a wholesale "fair trade" program,

under which BDI would not be able to offer its low-cost method of distribution to new customers or even to its existing customer, Safeway. As all other Olympia distributors had for years sold at identical prices "suggested" by Olympia, the sole effect of such "fair trade" program was to prevent the competition contemplated by BDI (R. 64-5; Hannah deposition, Plaintiff's Exhibit 4, pages 43-5). Olympia has conceded that the purpose of inaugurating its wholesale "fair trade" program in California was to prevent BDI from making any sales of Olympia products to customers (other than Safeway) located within the territories so allocated to other Olympia distributors and to prevent even a continuation of BDI's sales to Safeway: Olympia had no intention of fair trading at the wholesale level before BDI announced its intention to sell to others than Safeway (testimony of Robert Schmidt, Olympia president, in Plaintiff's Exhibit 3, page 14; testimony of Phil Hannah, R. 53), but when this announcement was received, Olympia moved fast to institute the fair trade program as soon as possible (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 15-17). Counsel for Olympia admitted in open court during the preliminary injunction hearing that Olympia fair traded for the purpose of making it "difficult if not impossible for sales to be made by BDI" in competing with its method of distribution for Olympia business of its other customers (statement of David Toy, R.T., page 95). These admissions are confirmed by the timing of the fair trading and by the testimony of Olympia's president, who has conceded that the purpose of fair trading was to "ensure an orderly marketing of our product" by preventing BDI from competing for sales (testimony of Robert Schmidt, Olympia president, in Plaintiff's Exhibit 3, page 16). Olympia's sales director, who actively partici-

pated in the decision to fair trade and who urged even harsher sanctions against BDI's refusal to abide by existing customer restrictions, was aware that wholesale fair trading would probably destroy BDI's existing business with Safeway at the same time as it prevented BDI from acquiring any new customers in other distributors' territories (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, page 20). Mr. Schmidt decided, however, to fair trade following BDI's August 7th announcement, rather than, in his words, "cut them off entirely" (*id.* at 16-17).

4. Olympia's refusal to deal with BDI was found to be for the purpose of preventing BDI from competing for sales to customers illegally assigned by Olympia to other distributors.

The record clearly supports the District Court's conclusion that it was this same purpose—to protect the exclusive territories of Olympia's other distributors—which motivated Olympia in subsequently, in September, refusing altogether to make further sales to BDI when it appeared that BDI had succeeded in making a few sales at the fair trade prices. Olympia's sales director had urged earlier that BDI be terminated for announcing its intention to compete for business assigned by Olympia to other distributors (testimony of Phil Hannah, in Plaintiff's Exhibit 3, page 16), but had been overruled in favor of the fair trade strategy, and at first he was persuaded that such strategy had been successful in destroying absolutely BDI's ability to make further sales to Safeway (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 23-4). A number of Olympia's other distributors had urged that Olympia refuse altogether to do business with BDI (*ibid.* at 7-10; *supra* at 5-6), and Olympia was well aware that those other distributors would be "unhappy" if BDI were permitted to sell, and succeeded in selling, to others

than Safeway (testimony of Robert Schmidt, Olympia president, in Plaintiff's Exhibit 3, pages 19-20). Olympia's sales director's conclusion that "fair trading" would have the same result as outright termination was immediately communicated to interested Olympia distributors (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, page 21).

When Olympia received a few further purchase orders from BDI, however, the sales director and Olympia's executive officers considered that the fair trade contracts had not immediately and completely succeeded in eliminating BDI and that Olympia would "have to make a decision" as to whether to "ship or not to ship" (testimony of Thomas L. Morgan, Olympia vice president, in Plaintiff's Exhibit 3, page 22). In the ensuing discussion between Olympia's executives, it was brought to the attention of Olympia's president that the products being ordered were likely destined for resale within other distributors' exclusive territories and that those distributors "could very possibly be hurt" unless BDI was prevented from attempting to so expand its sales (testimony of Robert Schmidt, Olympia president, in Plaintiff's Exhibit 3, pages 26-7). In light of that danger, and based upon Olympia's conviction that free competition between its distributors would be a "very inefficient operation," the decision was made to terminate BDI altogether as an Olympia distributor (testimony of Robert Schmidt, Olympia president, in Plaintiff's Exhibit 3, pages 25-8). The effectiveness of that termination was insured by the cooperation of Olympia's other distributors in their subsequent unanimous refusal to fill purchase orders they had received from BDI (R. 127-8). Notwithstanding Olympia's denial of any participation in those subsequent refusals to deal, the record shows that all distributors who received

such orders from BDI called Olympia before deciding what response they should give to BDI (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 30-34; Plaintiff's Exhibit 14).

The District Court recognized that both the fair trade contracts and the subsequent termination were resorted to by Olympia for the same purpose, as is evidenced by the Court's own comments during the hearing on BDI's application for injunctive relief (R.T., pages 113-14[1]) and by the wording of the temporary restraining order which was continued in effect as the preliminary injunction (R. 152, lines 2-18). Just as both acts had the same purpose, the authorities discussed below will show both acts to be equally illegal. It will be shown that the District Court therefore erred in its legal conclusion that it was not free to enjoin the fair trade at the same time as it enjoined Olympia from further refusals to deal.

SPECIFICATION OF ERRORS RELIED UPON

1. The District Court erred in refusing to grant a preliminary injunction which would prevent Olympia from enforcing against BDI fair trade price restrictions upon the sale of Olympia products to retailers, since the fair trade program was admittedly instituted for the sole purpose of protecting and enforcing an illegal system of territorial restrictions.

2. The District Court erred in limiting its preliminary injunction against Olympia's refusal to deal with BDI by reference to a maximum volume figure based almost entirely on purchases made by BDI prior to its attempt to sell to customers assigned by Olympia to other distributors.

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1. Note typographical error in hearing transcript: On page 113, lines 8-9, "to obstruct this" should read "obstreperous" and on line 16 "to obstruct BDI from" should read "obstreperous BDI."

SUMMARY OF ARGUMENT

It has been proven beyond doubt that Olympia maintains exclusive distributor territories and customer restrictions in California which are illegal under *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1246 (1967). Olympia admittedly instituted its fair trade program for the purpose of preventing BDI from competing for sales to customers illegally assigned under Olympia's agreements with other distributors (*supra* at 6-8). Subsequently, Olympia refused altogether to deal with BDI when it appeared that the fair trade program might not be entirely successful in achieving this objective (*supra* at 9). It was error of law, reviewable de novo and reversible on appeal, for the trial court to refuse to enjoin one means (fair trading) adopted to achieve the illegal object (enforcement of the illegal customer and territorial assignments to other distributors) while enjoining another means (refusal to deal) adopted to achieve the same object (*infra* at 22-5). Alternatively, even if the denial of adequate injunctive relief did not constitute error of law, it was a reversible abuse of discretion since the trial court based such denial upon a balancing of possible injury to Olympia's illegal distribution system—an improper consideration—against the proven irreparable injury to BDI.

ARGUMENT

1. Olympia's territorial restrictions constitute a per se violation of the Sherman Act, and it was equally illegal for Olympia to use the fair trade contracts and refusal to deal for the purpose of enforcing those territorial restrictions.

The facts as to Olympia's system of territorial and customer restrictions are proven almost entirely by testimony of Olympia executives and other evidence out of Olympia's own files (*supra* at 4-5). The District Court quite properly

entertained no doubt that Olympia's restrictions constituted a violation of the Sherman Act. Counsel for Olympia admitted early in the preliminary injunction hearing that "any system whereby a manufacturer seeks to restrict resales to a particular territory or to particular outlets is a per se violation of the federal antitrust laws" under the United States Supreme Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856. 18 L.Ed.2d 1246 (1967) (R.T., page 5), and the District Court later declared itself "pretty well satisfied" that Olympia had in fact violated the Sherman Act in the establishment and maintenance of its exclusive distributorship territories (R.T., page 80). Olympia had, in the District Court's opinion, "gone pretty far in the wrong direction, both before and after the bringing of this suit, as a matter of law" (R.T., pages 122-23). This conclusion is also set forth in the District Court's temporary restraining order, which now comprises the preliminary injunction order here on appeal (R. 152).

Olympia has admitted that it conducts its California resale operations through just such an illegal system of exclusive territories, and the evidence out of the mouths of the Olympia executives overwhelmingly corroborates the inescapable import of Olympia's territorial maps (*supra* at 4-5; R. 44-52; Plaintiff's Exhibits 1 and 2).

In *Schwinn*, the United States Supreme Court held that territorial restrictions such as those maintained by Olympia are "so obviously destructive of competition that their mere existence is enough" to violate the Sherman Act:

> "As the District Court held, where a manufacturer *sells* products to its distributor subject to territorial restrictions upon resale, a *per se* violation of the Sherman Act results. And, as we have held, the same principle applies to restrictions of outlets with which the distributors may deal and to restraints upon retailers

to whom the goods are sold. Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with which an article may be traded after the manufacturer has parted with dominion over it. *White Motor,* supra; *Dr. Miles,* supra. Such restraints are so obviously destructive of competition that their mere existence is enough. If the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale. . . ." (*ibid.* at 1865).

In *United States v. General Motors Corp.,* 384 U.S. 127, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966), the Court ruled illegal per se the efforts of a manufacturer and various distributors to procure the termination of a distributor who had violated restrictions upon the class of customers to whom he was permitted to sell by the manufacturer:

"The principle of these cases is that where businessmen concert their actions in order to deprive others of access to merchandise which the latter wish to sell to the public, we need not inquire into the economic motivation underlying their conduct. See Barber, Refusals to Deal Under the Federal Antitrust Laws, 103 U.Pa.L.Rev. 847, 872-885 (1955). Exclusion of traders from the market by means of combination or conspiracy is so inconsistent with the free-market principles embodied in the Sherman Act that it is not to be saved by reference to the need for preserving the collaborators' profit margins or their system for distributing automobiles, any more than by reference to the allegedly tortious conduct against which a combination or conspiracy may be directed—as in Fashion Originators' Guild of America, Inc. v. Federal Comm'n, supra, 312 U.S., at 468, 61 S.Ct., at 708." (86 S.Ct. at 1331)

Given the per se illegality of Olympia's territorial restrictions, it was to be expected that BDI would be granted

injunctive relief against both of the means used by Olympia to protect and enforce that illegal system—Olympia's fair trade program and its refusal to deal with BDI. This is so because the illegality of an agreement in restraint of trade extends to those acts, such as fair trading or refusal to deal, which are taken to further or enforce such restraints. It is too well accepted to admit of a contrary argument that acts which would otherwise be innocent are unlawful if done to give effect to a conspiracy illegal under the antitrust laws. In *American Tobacco Co. v. United States,* 328 U.S. 781, 66 S.Ct. 1125, 90 L.Ed 1575 (1946), the Court restated this doctrine (328 U.S. at 809):

> ". . . It is not of importance whether the means used to accomplish the unlawful objective are in themselves lawful or unlawful. Acts done to give effect to the conspiracy may be in themselves wholly innocent acts. Yet, if they are part of the sum of the acts which are relied upon to effectuate the conspiracy which the statute forbids, they come within its prohibition. . . ."

See also *United States v. Reading Co.*, 226 U.S. 324, 33 S.Ct. 90, 57, L.Ed. 243 (1912), among a number of other decisions which have set forth this doctrine. In *Simpson v. Union Oil Company of California,* 377 U.S. 13, 84 S.Ct. 1051, 12 L.Ed.2d 98 (1964), a refusal to renew a lease was ruled illegal where such action was in furtherance of an illegal agreement under the antitrust law. In *Walker Distributing Co. v. Lucky Lager Brewing Co.,* 323 F.2d 1 (9th Cir. 1963), the Ninth Circuit Court ruled that a beer wholesaler is entitled to relief under the antitrust laws where one of the "intended and actual effects" of a brewer's agreements with other distributors is to cut off the wholesaler's supply. To similar effect is the Ninth Circuit Court's decision in *Flintkote Company v. Lysfjord,* 246 F.2d 368, 377

(9th Cir. 1957), holding that a manufacturer's refusal to sell cannot be excused under the Sherman Act as a "lawful exercise of the supplier's business judgment" when the evidence discloses the refusal to be pursuant to an agreement or understanding with other customers.

The District Court committed fundamental error in its conclusion that it was incapable of granting effective injunctive relief because of the "exemption" from antitrust laws enjoyed by fair trade contracts under the Miller-Tydings and McGuire Acts (15 U.S.C. § 1; 15 U.S.C. § 45(a)) (R.T., October 3, 1967, pages 10, 41-2). The fact that fair trade contracts may be exempted by the provisions of those statutes from illegality as price-fixing agreements, however, does not mean that they are exempted from illegality when used, as here, to effectuate a purpose unlawful under the Sherman Act in another respect. A leading decision to this effect is *United States v. Bausch & Lomb Optical Co.,* 321 U.S. 707, 64 S.Ct. 805, 88 L.Ed. 1024 (1944), which affirmed a lower court's injunction against the further operation of fair trade contracts which had been executed to further an illegal scheme of horizontal price fixing prior to enactment of a fair trade statute. The later decision in *United States v. Frankfort Distilleries,* 324 U.S. 293, 65 S.Ct. 661, 89 L.Ed. 951 (1945), also rules that the Miller-Tydings exemption is no defense to an antitrust action based upon the abuse of fair trade contracts to achieve the purposes of an illegal conspiracy. Similarly, in *United States v. General Dyestuff Corp.,* 57 F. Supp. 642 (S.D. N.Y. 1944), the rule permitting restrictive covenants in connection with a sale was held not to justify such covenants when used in effectuation of a conspiracy otherwise actionable. Only two weeks before the preliminary injunction hearing the principle stated in these decisions was applied by the Fifth Circuit in a case arising

under the *Schwinn* decision with a result supporting BDI's application for adequate injunctive relief. In *Hensley Equipment Company v. Esco Corporation,* 383 F.2d 252 (5th Cir. 1967), a plaintiff suing for patent infringement was held barred from asserting its patent rights because of its abuse of patent privileges by establishing illegal customer restrictions similar to those of Olympia. The Court held that "this per se violation of the antitrust laws bars Esco from enforcing its patent" (at 264). Quoting from the *Schwinn* decision at length, the Fifth Circuit Court had no difficulty in dismissing the plaintiff's argument that the patent privilege rendered such restrictions exempt from the Sherman Act:

> ". . . As we understand the interplay of *Schwinn* and *Hartford-Empire,* and the underlying patent policy, there is no inquiry into purity of heart vs. bad motive, or market impact, or matters of what may seem to be essential fairness—a per se violation of the Sherman Act is deemed such a monopolistic action that the patentee is barred from enforcing the limited and special monopoly given him by the patent laws." (page 264)

The *Hensley* decision along with other decisions holding that an intent to accomplish an illegal object contaminates the use of otherwise legal means, including means specifically covered under specific "antitrust exemptions," were all briefed and argued before the District Court to no avail (R. 230). The Supreme Court has within the last month reemphasized the doctrine that exemptions from the antitrust laws are to be narrowly construed. In *Case-Swayne Company v. Sunkist Growers, Inc.,* 88 S.Ct. 528 (Dec. 1967), the Court points out that antitrust exemptions are "special exceptions to a general legislative plan" and therefore the courts are not justified in expanding the exemption. The

same doctrine of narrow construction of exemptions—and specifically the fair trade exemption—was applied to limit the application of the fair trade exemption in *United States v. McKesson and Robbins, Inc.,* 351 U.S. 305, 76 S.Ct. 937, 100 L.Ed. 1209 (1956), in which the Court states:

> ". . . We are not only bound by those limitations but we are bound to construe them strictly, since resale price maintenance is a privilege restrictive of a free economy. . . ."
> (351 U.S. at 316)

In the following decisions, activities exempt in themselves from operation of the antitrust laws have been held illegal where, as here, the exempt activity is used to achieve an illegal objective: *United States v. Borden Co.,* 308 U.S. 188, 60 S.Ct. 182, 84 L.Ed. 181 (1939) (agricultural cooperatives exempt under 15 U.S.C. § 17 from the antitrust laws held chargeable with violation of section 1 of the Sherman Act for conspiring with other groups); *Allen Bradley Co. v. Local Union No. 3,* 325 U.S. 797, 65 S.Ct., 1533, 89 L.Ed. 1939 (1945) (labor organization exempt under 15 U.S.C. § 517 from the antitrust laws held in violation of the Sherman Act by entering into contracts in restraint of trade with nonmember businessmen); see also *United Mine Workers of America v. Pennington,* 381 U.S. 657, 85 S.Ct. 1585, 14 L.Ed.2d 626 (1965); *Carnation Co. v. Pacific Westbound Conf.,* 383 U.S. 213, 86 S.Ct. 781, 15 L.Ed.2d 709 (1966) (exemption of certain conduct of common carriers under section 146 of the Ocean Shipping Act from the antitrust laws held inapplicable to conduct found illegal therein); *Manaka v. Monterey Sardine Industries,* 41 F.Supp. 531 (N.D. Cal. 1941) (exemption from antitrust laws set forth in Fishermen's Collective Marketing Act held inapplicable); *United States v. Minnesota Mining &*

Mfg. Co., 92 F.Supp. 947 (D. Mass. 1950) (Webb-Pomerene Export Trade Act exemption from the antitrust laws held inapplicable); *American Cooperative Serum Ass'n. v. Anchor Serum Co.*, 153 F.2d 907 (7th Cir. 1946) (hog cholera exemption in 7 U.S.C. § 852 held inapplicable to marketing agreement which violated Robinson-Patman Act). Although the District Court found sufficient illegality in the territorial restrictions to warrant injunctive relief against enforcement of those restrictions through Olympia's threatened refusal to deal, it refused to deny Olympia its second weapon of the fair trade contracts which the record showed also to be practically effective to enforce the same illegal restrictions on competition.

The record on this appeal therefore demonstrates with singular clarity the complete inconsistency between (a) the District Court's finding of per se illegality and resultant injunction against a refusal to deal, and (b) the Court's refusal to also strike the fair trade contracts and its imposition of a quantity limitation upon the injunction granted. The situation is very little different from that which faced the Seventh Circuit Court in *Charles E. Hires v. Consumers' Co.*, 100 Fed. 809 (7th Cir. 1900), in which the District Court, after finding that the defendant's beverage product infringed upon that manufactured by the plaintiff, granted preliminary injunctive relief against defendant's further use of the infringing label, but refused to enjoin defendant's further sales of the infringing bottle. The Court of Appeals reversed that refusal to enjoin, holding that the trial court was legally compelled by its finding of infringement to accord adequate relief to the injured plaintiff:

> ". . . here the right is clear, the infringement proven, and but thinly disguised. It will be impossible to give compensation in damages; for, from the very nature of

> the case, it will be wholly impracticable to ascertain the extent to which the piracy upon the complainant's right has been or may be carried, or to what extent the product of the defendant has been or may be palmed off upon the public as the product of the complainant. Complete relief can only be afforded by restraint of the infringement. Besides, the court below found nothing in the circumstances or situation of the parties to stay its hand. It issued its writ of injunction according to their rights as it determined them. It fell short in its judgment of the extent of those rights. The writ was clearly intended by the court to go to the full extent of the infringement, and was not controlled by other considerations. . . ." (page 813)

Here, as in the *Hires* case, the District Court has failed to give the plaintiff adequate injunctive relief notwithstanding the Court's determination that the acts sought to be enjoined are clearly illegal. Based as it was upon the District Court's error of law as to the exemption enjoyed by the fair trade contracts, that refusal to strike those contracts must now be set aside.

2. The effect of the District Court's refusal to grant the injunctive relief sought by BDI is to preserve Olympia's illegal territorial and customer restrictions and to force compliance therewith by BDI.

BDI's letter to Olympia of August 7, 1967, made clear that BDI desired the freedom to compete for sales of Olympia products to all of its customers (R. 74-5). It is precisely this freedom to compete which the Supreme Court sought to protect in the *Schwinn* decision, and in fact the import of that decision was pointed out by counsel for BDI to Olympia's counsel before BDI's formal announcement of its intention to expand its sales (R.T., page 86). It is also this freedom which the District Court here properly decided

was deserving of protection, and which it purported to protect by issuing the preliminary injunction that it did. By limiting its injunction to a set quantity maximum, however, and by allowing Olympia's "fair trade" contracts to stand, the District Court only sanctified and preserved the very illegality which it sought to strike down.

It is shown above (*supra* at 6-9), as it was in the preliminary injunction hearing, that BDI's singular appeal to retail customers is its ability to give central warehouse delivery without the confusion and delay attendant to store-door delivery, and thereby to permit efficient handling by the retailer at a saving in price. It is just this appeal which Olympia feared would permit BDI to compete successfully in other distributors' exclusive territories, and which Olympia sought to eliminate by its fair trade strategy (*supra* at 6-8). As already noted, Olympia had the further hope and belief that such fair trading would even discourage Safeway from doing business with BDI, in which event BDI would be destroyed entirely and Olympia's territorial restrictions would be subjected to no further attack (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 20-21).

Olympia has not left to chance the possibility that fair trading would have such adverse effects on BDI, but rather has taken direct steps to replace BDI with other distributors wherever a retailer can be persuaded that BDI can no longer offer any competitive advantage. Immediately after fair trading, Olympia's field personnel began making calls on Safeway seeking to divert Safeway's business to the store-door type distributors handling the territories within which Safeway has its retail outlets (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 34-5). Olympia was kept current on the success of this effort not

only through the reports of its field personnel as to what Safeway sales were being taken from BDI (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, page 34), but also through numerous conversations with those distributors who had received Safeway purchase orders and had called to report the fact to Olympia (testimony of Phil Hannah, Olympia sales director, in Plaintiff's Exhibit 3, pages 36-8). At the time of the preliminary injunction hearing, Olympia had already succeeded in diverting the Safeway, Purity and Louis Stores business to other distributors (Plaintiff's Exhibits 12, 13, 14). What chance BDI might have to mitigate its losses by selling to others than Safeway, of course, is equally destroyed by the District Court's quantity limitation based upon previous sales, which effectively prohibits BDI from filling new orders during periods of comparable demand even if it should succeed in procuring them.

In effect, therefore, the District Court, by permitting Olympia to continue its fair trade program and by limiting the amount of beer which BDI may purchase from Olympia, has continued illegal restraints which Olympia could not lawfully impose and to which BDI could not lawfully submit. It has permitted Olympia almost complete protection of its illegal restrictions by (1) continuing the fair trade contracts which have destroyed most of BDI's business with Safeway and which effectively minimize the possibility of BDI getting any new customers, and (2) limiting the quantity which Olympia must sell to BDI so that BDI has no assurance of being able to supply new customers even if it somehow can get orders. BDI's competitive strength is thereby eliminated, and any threat which BDI may have posed to Olympia's illegal system of restraints upon competition is removed.

3. The District Court's refusal to grant injunctive relief against Olympia's illegal fair trade program, based as it was upon fundamental error of law, is reviewable de novo by this Court.

The trial court did not possess any discretion to deny a preliminary injunction on the basis of a clear error of law. The District Court's failure to enjoin enforcement of Olympia's fair trade contracts was an error of law similar to that which has impelled the appellate courts to direct the grant of relief in a number of similar situations. There is no presumption of validity accorded by the Appellate Court to a trial court's determination of a question of law. The nature of the de novo consideration of legal issues on appeal was well illustrated recently in *United States v. Bliss & Laughlin, Inc.,* 371 U.S. 70, 83 S.Ct. 156, 9 L.Ed.2d 120 (1962), in which the Supreme Court summarily vacated judgment denying a preliminary injunction in an antitrust proceeding and remanded the case to the District Court of the Southern District of California for reconsideration in light of the correct rule of law. The trial court had held that there had been a failure to prove reasonable probability of substantial lessening of competition by the purchase of assets of a corporation in a case involving section 7 of the Clayton Act. The Supreme Court in its opinion merely cited a recent case establishing the correct test.

In *Ring v. Spina,* 148 F.2d 647 (2d Cir. 1945), the Court of Appeals reversed the denial of preliminary injunction in an antitrust case, stressing that a denial of relief "based in substantial measure upon conclusions of law . . . can and should be reviewed by the Appellate Court. The Court states:

> "The granting or denial of an interlocutory injunction is usually relegated to the discretion of the District Court, which an appellate tribunal is reluctant to disturb. State of Alabama v. United States, 279 U.S. 229,

230, 231, 49 S.Ct. 266, 73 L.Ed. 675. But here the trial court's denial of the injunction was based in substantial measure upon conclusions of law which can and should be reviewed because of their basic nature in this litigation. Cf. Bowles v. Nu Way Laundry Co., 10 Cir., 144 F.2d 741; Bowles v. May Hardwood Co., 6 Cir. 140 F.2d 914; Coty, Inc. v. Leo Blume, Inc., 2 Cir., 24 F.2d 924; Schey v. Turi, 2 Cir., 294 F. 679. The case then should be remanded for action by the District Court in the light of the legal principles thus enunciated." (page 650)

Similarly, in *Philadelphia Record Co. v. Manufacturing Photo-Engravers Ass'n.,* 155 F.2d 799 (3d Cir. 1946), the District Court had denied a preliminary injunction on the basis of a conclusion of law that there was not a sufficient showing of interference with interstate commerce in violation of the Sherman Act. The Appellate Court reversed, with direction to issue a preliminary injunction, on the ground that as a matter of law the plaintiff was entitled to the relief:

"We think that the plaintiff not only has shown a case where 'fair play' indicates an injunction as stated by the District Court, but where as a matter of law it is entitled to such injunction. . . ." (page 803)

"The order of the District Court is reversed and the cause remanded with directions to that Court to grant a preliminary injunction forthwith to the plaintiff against the defendants. . . ." (page 804)

As Judge Hough succinctly stated in reversing the denial of a preliminary injunction for error of law in an unfair competition case, "But here no fact is in doubt; there is before us only a question of law, and *law not only guides but coerces discretion." National Picture Theatres v. Foundation Film Corp.,* 266 Fed. 208 (2d Cir. 1920). The doctrine requiring the Appellate Court to step in to rectify erroneous

legal conclusions is well set forth in *Societe Comptoir De L'industrie etc. v. Alexander's Dept. Stores,* 299 F.2d 33 (2d Cir. 1962):

> "Although the granting or denial of a preliminary injunction is within the discretion of the court to which it is addressed, where it is plain that the disposition was in substantial measure a result of the lower court's view of the law, which is inextricably bound up on the controversy, the appellate court can, and should review such conclusions. Ring v. Spina, 148 F.2d 647, 650, 160 A.L.R. 371 (2 Cir. 1945)." (pages 35-6)

As the Court of Appeals for the Third Circuit stated in *Bergen Drug Company v. Parke, Davis & Company,* 307 F.2d 725, 727, 728 (3d Cir. 1962), the public interest in enforcement of the antitrust laws weighs particularly heavily in favor of the grant of temporary relief in an antitrust case. The trial court in *Bergen* had denied a preliminary injunction on the basis of an error of law—that no "statutory or other legal basis" existed to grant the injunction. The Appellate Court reversed, holding that the Colgate rule did not apply to permit defendant to refuse to deal with plaintiff "in order to stifle the main action," an antitrust case, stating:

> "It is clear to us, based on the unchallenged facts in the record, that a temporary injunction should have been granted.
>
> "Private actions are an important means of enforcing the antitrust laws of the United States. Such actions are a vehicle for serving not only the immediate interests of the litigants, but the continuing interest of the public in a smoothly functioning and unobstructed system of commerce. Congress voiced its recognition of the importance of private actions by enacting special provisions for treble damages and attorneys' fees. That, indeed, weighs heavily with this court in considering whether equity jurisdiction should be exercised." (page 727)

The fact that the District Court enjoined one prong of Olympia's two-pronged anticompetitive conduct (the refusal to deal) did not in any way lessen its duty to enjoin the other prong of the anticompetitive conduct (the fair trade program). Indeed, the fact that the District Court did conclude that BDI was entitled to an injunction against the refusal to deal renders logically indefensible the Court's refusal to enjoin the fair trade program which was established for and achieves the very same illegal purpose (*supra* at 6-10).

In our case, the evidence is clear: Olympia's anticompetitive purpose in fair trading, as well as in refusing to deal, is proven out of the mouths of its top executives. The Supreme Court in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1246 (1967), has clearly enunciated that the territorial restrictions which Olympia sought to preserve constitute per se violations of the Sherman Act. Plaintiff is entitled as a matter of law to relief; yet the preliminary injunction gave relief against only one of Olympia's two illegal weapons for destruction of BDI. As we have shown, the trial court had no discretion to deny relief against both. There exists no presumption that the trial court was correct in its application of the law. Under these circumstances, the Court of Appeals will rectify the error of law by directing issuance of the injunction for which we have prayed.

4. The District Court abused its discretion in balancing Olympia's desire to preserve its patently illegal distribution system against irreparable injury to BDI.

Even if leaving in effect the fair trade program illegally designed to prevent BDI from selling Olympia beer to customers of other wholesalers were not error of law, as argued above, it was most certainly an abuse of discretion, for this

compromise and ineffectual remedy was arrived at by the Court in deference to Olympia's illegal distribution system. The Court made this clear (R.T., pages 120-23):

> ". . . I am inclined to believe from what's before me that if your client not only gets supplies but also is in effect, by action of this Court, given immunity from rights deriving from state statute, that there may as a consequence be irreparable damage to Olympia, and that Olympia may lose what it has undertaken to build up over many years, and that is the good relationships with distributors. One thing I learned about the beer industry in the Schlitz case was that it is pretty important to have the goodwill of distributors to get your product on the shelves where the public will get it. And it's pretty hard, no matter how much you advertise and no matter how good your product may be, to make the grade without that.
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> "Now I'm not saying that that desire justifies—I say it does not justify under the law—territorial obstruction contrary to Schwinn, or other practices contrary to law. But this is a state law which has as part of its underlying philosophy the idea of protecting the goodwill attending a mark such as Olympia or a name such as Olympia against the consequences of price-cutting. And if I at this point deny, in effect, by injunction the advantage of the state law to Olympia, they can make a strong case, it seems to me—and to you, too, I think—that this will irreparably damage them by causing distributors to not push their product, to not get the preferred space on the dealers' shelves, and so on and so forth. That may take a long time, because then. . . . Now, there's access to the consumer for Olympia products, because there's nothing that blocks the fulfillment of the demand created by their advertising, by what they undoubtedly believe is a superior product. But if

as a consequence of the plaintiff in this case cutting prices, they lose that break on the shelves or that dealer cooperation through the distributing and servicing, no matter how good their product is and no matter how strong their advertising. It can just raise ned with them, and it's something, once the public gets off a particular brand, it's pretty hard to get back in, I suppose. So they have their problems in this matter.

"Now, I am frank to say to you and to them, and Mr. Schmidt is here and his attorneys are here, that it looks to me like they have gone pretty far in the wrong direction, both before and after the bringing of this suit, as a matter of law. I am not talking about their morals, I am not saying I agree with the law that put them in this position. I am not sure that I do. But I don't make the laws; it is my duty to interpret them and apply them. But I am just loathe to use the power of this Court to do an act which may irreparably injure them."

In short, the trial court refused to enjoin an illegal fair trade program the sole purpose and effect of which was to preserve customer and territorial restraint of trade and competition.

In *Bowles v. Quon,* 154 F.2d 72 (9th Cir. 1946), this Court, in reversing the denial of an injunction, attempted to remove the mystique from the phrase, "abuse of discretion" by defining it (page 73): "An abuse of discretion is a plain error, discretion exercised to an end not justified by the evidence, a judgment that is clearly against the logic and effect of the facts as are found." Thus the petitioner seeking a preliminary injunction is not asking for a dispensation of grace, either the grant or denial of which will be affirmed on appeal. Judge Learned Hand in *Barnett v. Equitable Trust Co.,* 34 F.2d 916 (2d Cir. 1929), had the following to say concerning appellate review of the trial court's exercise of discretion in the award of attorneys' fees (page 920):

> "It is argued that we should not disturb it, unless there has been an abuse of discretion. Perhaps so, but that phrase means no more than that we will not intervene, so long as we think that the amount is within permissible limits; if our conviction is definite that it is, we cannot properly abdicate our judgment. . . ."

Another explanation of the function of appellate review of the exercise of discretion is set forth in *Carroll v. American Fed. of Musicians of U.S. & Canada,* 295 F.2d 484 (2d Cir. 1961). In reversing the denial of a preliminary injunction, the Court pointed out, quoting Chief Judge Magruder, that, " 'Abuse of discretion' is a phrase which sounds worse than it really is. All it need mean is that, when judicial action is taken in a discretionary matter, such action cannot be set aside by a reviewing court unless it has a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." The Court went on to say (page 488):

> ". . . Congress would scarcely have gone to the pains of amending the Evarts Act, 26 Stat. 826, 828 (1891), which had provided interlocutory review over the grant or continuance of injunctions as an exception to the general requirement of finality, so as also to include their denial, 28 Stat. 666 (1895), and then of repeating the process when it enacted § 129 of the Judicial Code of 1911, 36 Stat. 1134, modifying 31 Stat. 660 (1900) in this respect, unless it had thought that meaningful duties were being imposed upon the Courts of Appeals. . . ."

As shown above, we believe that the Court was required by law to grant relief without balancing conveniences (*supra* at 22-5). Yet even if the Court were permitted to balance equities, it was an abuse of discretion to strike the balance which the Court made. BDI's proof of its irreparable injury cries for relief (R. 111-120, 250-58). On the other side of the

scales, Olympia's own showing of the injury it claims it would suffer was an attempt to show economic justification for a distribution system which is illegal per se (*infra* at 30-31). In other words, as we will now show, Olympia proved absolutely no injury to merit consideration.

Upon looking to the proof which Olympia offered in support of its opposition to the preliminary injunction, the error in denial of adequate relief becomes most obvious. For Olympia's argument as to the injury it claims it would suffer if the injunction were granted has ignored the definitive holding of the Supreme Court of the United States in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1246 (1967), that assignment of exclusive territories is illegal per se. The only claim of damage from denial of a preliminary injunction which Olympia is able to muster forth is a claim that Olympia will be injured if it must give up its illegal distribution system. Thus Mr. Hannah sets forth in his affidavit a fanciful argument in favor of the full-service distributor as against the central warehouse distributor (R. 199-202, 220-21). For over fifteen years, of course, Olympia has been willing to permit BDI to sell its products to Safeway on a central warehouse basis (R. 63-4). Thus it is the possible expansion of BDI's business which Olympia claims as injury—in other words, Olympia desires to prevent competition by BDI. Mr. Hannah sets forth what he claims will happen if BDI is permitted to make sales in territories assigned exclusively to other distributors: He expects that other distributors will lose business: "All other distributors . . . would, of course, lose the large retailers as customers" (R. 205).[2] He adds, "Un-

2. There is not the slightest evidence in this record that BDI intends to or could expand its business as speculated by Mr. Hannah. Obviously, it would be impossible to do so if other distributors would compete by offering retailers the efficient service BDI's customers desire.

doubtedly, Olympia's other distributors would find it economically impossible to make store deliveries to . . . small accounts" (*ibid.*). He makes it most clear that it is *competition* by BDI with other distributors which he fears: "Olympia has, therefore, been quite unwilling to see central warehousing extended in the State of California" (R. 202); the injury he foresees to Olympia would come from "the continued and expanding sales of BDI to all central warehouses in the State" (R. 206); "widespread extension of central warehousing" (R. 220, page 2); and "a shift to central warehousing" (R. 221). The speculative computations of monetary damage claimed for Olympia in the affidavit of Mr. Morgan are all based upon the fears and imaginings of Mr. Hannah as to what would happen if Olympia's exclusive territorial and customer restrictions upon wholesalers are invalidated so that BDI or other distributors like BDI may compete by attempting sales to customers presently assigned to other distributors (R. 227-9).

Olympia's points are arguments which attempt to support a distribution system declared by the Supreme Court to be illegal per se. In the *Schwinn* case itself the Court swept aside similar arguments as wholly inapplicable to a per se violation (87 S.Ct. at 1863):

> ". . . Schwinn contends, however, and the trial court found, that the reasons which induced it to adopt the challenged distribution program were to enable it and the small, independent merchants that made up its chain of distribution to compete more effectively in the marketplace. Schwinn sought a better way of distributing its product: a method which would promote sales, increase stability of its distributor and dealer outlets, and augment profits. . . ."

Olympia's argument of the irreparable injury it would suffer is almost a copy of that which had been made by

Arnold, Schwinn & Co. Yet the Supreme Court rejected Schwinn's argument as inapplicable to a per se violation (*ibid.*):

> ". . . But this argument, appealing as it is, is not enough to avoid the Sherman Act proscription; because, in a sense, every restrictive practice is designed to augment the profit and competitive position of its participants. Price fixing does so, for example, and so may a well-calculated division of territories. See United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 60 S.Ct. 811, 84 L.Ed. 1129 (1940). The antitrust outcome does not turn merely on the presence of sound business reason or motive. . . ."

The Court then ruled that Schwinn's arguments were inapplicable because territorial and customer restrictions are illegal per se (87 S.Ct. at 1865). So here, wholly irrelevant is Olympia's entire claim of damage it would suffer if the relief we seek should be granted. Olympia's claimed "damages" are nothing but an illegal advantage it would like to retain by maintaining illegal restrictions on distribution.

We submit that there is no balance to be struck at all. BDI's proof of irreparable injury is overwhelming and was accepted by the Court; Olympia can only say that it earnestly desires to continue to violate the law.

CONCLUSION

As in *Ring v. Spina* (*supra* at 22-3), the trial court's denial of a preliminary injunction against the illegal fair trade "was based in substantial measure upon conclusions of law which can and should be reviewed because of their basic nature in this litigation." Otherwise, the likelihood is that the trial court's basic error will be carried through the many months, and possibly years, until the trial on the merits and

until remedied by this Court on appeal on the merits should plaintiff manage to survive so long.

Dated: January 26, 1968.

Respectfully submitted,

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By B. H. Parkinson, Jr.

Counsel for Appellant Beverage Distributors, Inc.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

B. H. Parkinson, Jr.

Attorney

(Appendix Follows)

Appendix

EXHIBITS IN RECORD

Exhibits	Identified, Offered and Received
Pl. 1	Tr. 20
Pl. 2	Tr. 20
Pl. 3	Tr. 40
Pl. 4	Tr. 40
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Pl. 16	Tr. 142
Pl. 17	Tr. 149
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No. 22364 and A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellant,

vs.

OLYMPIA BREWING COMPANY,
a corporation,

Appellee.

OLYMPIA BREWING COMPANY,
a corporation,

Appellant,

vs.

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellee.

Appeal from the United States District Court for the Northern District of California

---

ANSWERING AND OPENING BRIEF OF APPELLEE-APPELLANT OLYMPIA BREWING COMPANY

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ANSWERING AND OPENING BRIEF OF APPELLEE-APPELLANT OLYMPIA BREWING COMPANY

Pursuant to a stipulation of the parties, Olympia Brewing Company (Olympia) is filing a single consolidated brief as appellee answering the brief of Beverage Distributors, Inc. (BDI), plaintiff below and appellant in No. 22364 here, and as appellant on its cross-appeal, No. 22364-A. For the sake of simplicity, Olympia will set out its statement of jurisdiction and of the case at the beginning of the brief, but will answer all points raised in BDI's Opening Brief [Section V below] before arguing its own position as appellant [Section VIII below].

I

JURISDICTION

BDI has stated this court's jurisdiction was invoked under 28 U.S.C. § 1291 following denial of application for preliminary injunction in a suit brought pursuant to the antitrust laws of the United States [15 U.S.C. Sections 1, 2]. In fact, appellate jurisdiction rests upon the provisions for appeal from an interlocutory order granting or refusing an injunction [28 U.S.C. § 1292(a)(1)]. Olympia's cross-appeal, which likewise rests upon Section 1292(a)(1), was filed October 24, 1967, within the time allowed therefor by F.R.C.P., Rule 73(a).

II

STATEMENT OF THE CASE

While Olympia would not normally restate the case before this court in an answering brief, it is necessary that the numerous gross misstatements of fact and omissions be corrected. Olympia would not have this court think it accedes to the interpretation of the evidence which BDI makes. It does not. Specifically, Olympia submits the following:

1. The district court, *following a stipulation solicited by BDI* [2 R.T. 65], made no findings of fact or conclusions of law. The court made it perfectly clear that it preferred not to make findings on the state of the evidence before it [2 R.T. 48-49] and that it entered the order appealed from for the sole purpose of maintaining what it conceived to be the status quo [2 R.T. 40-41]. It is therefore incredible that BDI should urge upon this court any "findings" or "conclusions" of the court below — they simply do not exist. The reference to any recital contained in the temporary restraining order [BDI Br. 12]

must be understood in this light and in light of the additional fact that upon issuance of the temporary restraining order Olympia specifically disavowed plaintiff's contentions and reserved all its rights pending trial [R. 155]. BDI is therefore confronted at the outset of its appeal with absence of those factual premises on which its argument entirely rests.

2. Olympia does not maintain a system of exclusive territorial or customer restrictions such as are proscribed by *United States v. Arnold, Schwinn & Company,* 388 U.S. 365, 87 S.Ct. 1856, 18 L.ed.2d 1249 (1967). Olympia's distributors have complete freedom in selecting to whom and where they make sales [R. 196, 222-23; Hannah depos. pp. 105-6]. The fact that a distributor is responsible for servicing a particular geographical area imposes neither any *restriction* on him to avoid sales outside that area nor creates any *right* to expect absence of competition within the area. The record before the court contained a variety of instances in which Olympia distributors were making sales beyond their areas of responsibility [Hannah deposition, Exhibit 4, pp. 16-30, 216] without any reprisal or threat on Olympia's part [R. 44-45]. Since Olympia does not sell beer directly to retailers, it reserves exclusively to itself no group or class of potential customers. Hence there does not exist in this case the sort of "customer restriction" which the Supreme Court had before it in *White Motor Co. v. United States,* 372 U.S. 253, 83 S.Ct. 696, 9 L.ed.2d 738 (1963).

3. BDI as a distributor of Olympia Beer was subject to neither customer nor territorial restrictions on its sales of Olympia in California. To understand BDI's position as a beer wholesaler, it is necessary to discuss something of its history. BDI first distributed Olympia Beer in 1953 [R. 203]. At that time it was a wholly owned subsidiary of Safeway Stores, Inc. [Girard depos., Ex.

A., pp. 6-7] Until Olympia was able to sell beer to BDI, Olympia Beer was not carried by Safeway. By the same token, only those beers carried by BDI were stocked by Safeway [R. 202]. In 1958 Safeway sold the stock of BDI to its officers [Girard depos. p. 7]. The sale was accomplished in May 1958. In July 1958, A. D. Morton, at the time the principal shareholder and president of BDI [Girard depos. p. 8] wrote a self-serving letter to Olympia stating it chose to limit its sales to Safeway *as it had in the past* [R. 207]. Olympia acknowledged this letter [R. 70-73]. It did nothing else. Deposition testimony of Charles Jones, vice president of BDI, was submitted to the effect that BDI sold Olympia Beer everywhere in California it was licensed to do so [See App. A.][1]. Mr. Jones also testified that so far as he was aware no one at Olympia had ever discussed with anyone at BDI sales by BDI to any retailer other than Safeway [See App. A]. The record is absolutely devoid of *any* evidence that Olympia has taken *any* steps at *any* time to limit or restrict the nature or scope of BDI's sales efforts. Between 1958 and 1967 several other brewers discontinued sales in California of their beer to BDI [R. 68-69]. Safeway thereupon discontinued stocking each such beer [R. 202]. When Olympia notified BDI of its decision to terminate the distributor, it likewise expected to lose the Safeway business [Hannah depos. p. 133]. In fact, no distributor other than BDI sold

[1] Part of the record designated on appeal was the affidavit of David Brice Toy filed in opposition to the application for preliminary injunction [R.T. 2]. This affidavit, dated September 28, 1967, was omitted from the record transmitted to the court of appeals by the district court. It contained excerpts from deposition testimony of Mr. Jones given in 1966 in another suit, "Thriftimart, Inc. v. BDI, et al", L. A. Superior Court No. 863340. The parties have stipulated to supplement the record on appeal with this affidavit, but it is not part of the record as this brief is written. Rather than delay briefing of the case, Olympia is quoting the sections of Mr. Jones' testimony to which reference is made in Appendix A.

Olympia Beer to Safeway until September of 1967 [Hannah depos. p. 99 ff.]. BDI had a 15-year monopoly.

4. BDI is not a parallel competitor of any other Olympia distributor in the State of California. As BDI acknowledges [BDI Br. 3], it "operates differently" from other distributors. It does not provide many of the services of beer distributors which Olympia considers important to the proper merchandising of its product. A substantial portion of the affidavit of Phil H. Hannah, Olympia's Director of Sales, points out these differences [R. 199-202]. BDI does not provide these services because it does not go near its retail customers' stores. When BDI commenced soliciting orders for Olympia Beer from retailers other than Safeway, it did not seek to obtain orders from any small outlet which would require a small delivery or in-store servicing [Girard depos. pp. 40-42]. It sought orders only from customers capable of warehousing beer as was Safeway [R. 64]. Bearing in mind that Olympia Beer is fair traded at retail [R. 160] and (wholesale trading aside) cannot be sold on a quantity discount basis at wholesale[2] it is obvious BDI's object was to isolate for itself an important segment of the retail market [R. 205-6] by offering an apparently larger margin of profit between a fixed retail price and wholesale — a margin which it could not afford to give if it provided either service or sales on a full-scale basis [R. 205].

5. In undertaking a program of wholesale fair trade, Olympia neither consulted with nor followed the instructions of any other person. There was no conspiracy [R.T. 126]. On August 8, 1967, the officers of Olympia, after consulting with counsel, determined to institute a

2 Rule 105 of the California Alcoholic Beverage Control Department, 4 Cal. Admin. Code § 105, quoted at R. 178, requires all sales in a given county to be made at the same price by a particular wholesaler regardless of the quantity.

policy of wholesale fair trade in California [Hannah depos. p. 53; Schmidt depos. Ex. 5, p. 62]. Thereafter, Olympia filled every order which BDI submitted to it and did not cancel until BDI commenced the present action [R. 245-46]. BDI in its brief misstates the statement of counsel by casting it and the testimony of Olympia's officers as "admissions" that the fair trade program was intended to restrict BDI's sales. Counsel for BDI made this same misstatement to the trial court and the trial court rejected it [R.T. 96]. BDI was left free to sell any warehouse customer it wished or could, or indeed to commence route sales in the full service fashion [R. 76]. The fact is that until the time of hearing BDI was making a variety of sales to different retailer customers [Girard depos. pp. 32-39, 44], but at its own choice had made no attempt to begin sales to small retailers [Girard depos. pp. 41-42].

6. Olympia's decision to terminate was not reached from the same considerations which prompted its decision to fair trade. There is nothing in the record to sustain the repeated misstatement of BDI that Olympia's termination of BDI on September 7 was the result of any conspiracy or for the purpose of maintaing any system of territorial or customer restrictions. There is no statement by the court, and obviously no finding or conclusion to this effect. The court's comments are to the contrary [2 R.T. 31]. All officers of Olympia who testified by deposition or by affidavit stated repeatedly that the sole consideration motivating their decision to terminate BDI was the commencement of a substantial piece of litigation by BDI. The timetable is as follows [2 R.T. 21][3]:

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3 The transcript cited refers, at 1.20 to orders received "August" 5 and 6. Counsel mis-spoke himself: the dates were September 5 and 6 [Hannah depos. p. 125].

August 10 — Olympia commences fair trade policy;

August 18 — Olympia makes last shipment of pending BDI order;

August 30 — BDI commences the within suit;

September 1 — Suit is served by BDI in Olympia, Washington;

September 5 — BDI submits new order to Olympia;

September 7 — BDI is terminated as distributor.

Olympia's officers stated repeatedly that they corporately felt no capacity to do business in the intimate circumstances required between brewer and distributor with one who alleges those facts appearing in the complaint herein. [R. 204, 223; Hannah depos. p. 122; Schmidt depos. pp. 66-67; Morgan depos. Ex. 6, p. 13] For better or worse, Olympia's decision to terminate must stand on this basis. It cannot be placed on any other basis.

III

SUMMARY OF ARGUMENT

The trial court's view of the facts does not sustain BDI's argument. The court acted solely to maintain the status quo and not to enjoin any alleged territorial or customer restrictions. This is clear despite a lack of specific findings as called for by F.R.C.P. 52(a). Thus *United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 87 S.Ct. 1856, 18 L.ed.2d 1249 (1967) is not controlling. Olympia's institution of fair trade pricing at wholesale was entirely proper and lawful, not tainted by improper motive or design. In the circumstances there is no basis on which to reverse the trial court's denial of a preliminary injunction against that policy. Moreover, BDI has not shown entitlement to *injunctive* relief as such.

IV

OLYMPIA'S ARGUMENT AS APPELLEE

1. The Order Made by the District Court Is Consistent With the Court's Professed Desire Solely to Maintain the Status Quo Between the Parties Pending Trial.

At the threshold of any consideration of the legal issues framed by appellant's opening brief stands the fact that the trial court did not make findings of fact or conclusions of law at the end of the three-day hearing on BDI's application for a preliminary injunction [2 R.T. 65]. As indicated above, BDI's counsel solicited a waiver of findings in open court and this waiver was agreed to by counsel for Olympia [2 R.T. 65].

The rule of California *state* appellate procedure is clear that an absence of findings or conclusions obliges an appellate court to infer necessary findings in support of the order or ruling of the trial court. No extensive citation of authority is necessary to sustain this proposition.

See, e.g. *Johnson v. Rich,* 150 Cal.App.2d 740, 747 (1957).

This court has not ruled on the question whether F.R.C.P., Rule 52(a) gives a federal appellate court the same discretion or imposes a mandatory obligation on the trial court, not subject to waiver by the parties, to make findings as an aid to appellate review. See, e.g. *Berguido v. Eastern Air Lines, Inc.,* 369 F.2d 874, 877 (3rd Cir. 1966), aff'd on rehearing 378 F.2d 369 (1967) to this effect.

See also *Mayo v. Lakeland Highlands Canning Co., Inc.,* 309 U.S. 310, 316, 60 S.Ct. 517, 84 L.ed. 774 (1940; *Hopkins v. Wallin,* 179 F.2d 136 (3rd Cir. 1949); 5 Moore, *Federal Practice* 2668-70, § 52.07.

Given the state of the record, this Court has three choices:

It can adopt the California practice and assume the trial court would make adequate findings to protect its order (as the trial court indicated it would [2 R.T. 48-49]). As is said in *Johnson v. Rich, supra,* at 747:

> "There is an intention to admit the sufficiency of the findings and the evidence."

Alternatively, it can adopt one of the two options suggested in *Berguido:* either remand the matter to the trial court for special findings to supplement the record on appeal (as was done in *Mayo v. Lakeland Highlands Canning Co., Inc., supra*), or examine the record to determine if a "full understanding" of the trial court's ruling can be gleaned. 369 F.2d at 877.

Olympia does not suggest the drastic alternative of remand. In this instance, the basis for the court's ruling seems clear: A desire to maintain the status quo [2 R.T. 40-42].

By examining the comments of the court during argument of counsel, it is clear that the court did not make those "findings" upon which BDI now relies in in presenting its appeal. In dealing with the particular points raised by BDI, the court's comments indicate clearly that it was not satisfied BDI had proved the matters alleged by it in the following respects:

> (1) The court was not persuaded that BDI had proved a rigid territorial allocation of the Schwinn type by Olympia:
>
> "THE COURT: It seems to me you want to say there was no Schwinn type of rigid territorial allegation . . .

"I think there is a good deal in the record to support that.

"MR. TOY: Including, of course, the depositions and affidavits of officers of Olympia and the affidavits of their suppliers.

"THE COURT: That is right and to some extent even some of the things that you glean from some of the materials filed in behalf of plaintiff." [2 R.T. 20]

(2) Likewise BDI did not adequately show that Olympia was improperly motivated or acted in pursuance of an unlawful purpose:

"THE COURT: I am suggesting that the quantum of proof now before me to establish that this was the use of the Fair Trade Act, a shield against unlawful antitrust action — the quantum of proof there is not quite sufficient to convince me." [R.T. 126]

* * *

"THE COURT: I don't think you need go that far. I am not satisfied that there has been an adequate showing of the impropriety of the defendant's motives here . . .

"I don't think you [e.g. counsel for Olympia] need to pursue that, because I think if the motive is bad — contrary to your view — and the conduct is done in pursuance of unlawful purpose, helps effectuate unlawful purpose, and if the damage is irreparable, I have no difficulty in granting a preliminary injunction. But it doesn't seem to me that either or both of these requirements are implicit in the question of — I will put it another way.

"The burden of establishing both of those things has not in my opinion been met by the evidence before me at this juncture." [2 R.T. 9]

(3) As the previous quotation indicates, BDI did not satisfy the trial court that maintenance of Olympia's wholesale fair trade policy pending trial would cause BDI irreparable damage. [See also the colloquy at R.T. 119-20].

(4) Nor did BDI show the September 7 termination of BDI by Olympia violated the anti-trust laws of the United States:

"THE COURT: I am not asking you [e.g. counsel for BDI] to concede and there is no basis for your conceding that the stoppage in this instance was lawful. All I am saying is that you think it was unlawful. I am saying that maybe it was and maybe it wasn't.

"I am not too sure." [2 R.T. 26]

(5) The court did no more than preserve what it understood to be the status quo on the strength of what it took to be its equitable powers *extrinsic of* anti-trust considerations [2 R.T. 40-42].

The desire to maintain status quo *pendente lite* is, of course, a proper motivation for the granting of a preliminary injunction. In the appellant portion of this brief [Section VIII] Olympia will point out why the status here was not properly subject to injunctive preservation. For present purposes, Olympia notes only that the court acted pursuant to its general equitable, not its anti-trust powers.

Read in this light, the District Court's order has internal consistency: BDI is given the same source of supply which it had at the time it commenced suit against Olympia. Olympia is given the right to enforce its fair trade contract made in reliance upon California statutory authority.

BDI's entire argument is predicated on the false premise that the trial court's order is internally inconsistent. It reaches this position by asserting as facts found and conclusions made certain factual premises which are disputed by Olympia and which the Court did not adopt.

By incorrectly analyzing the court's view of the factual questions before it, BDI reaches the false conclusion that the trial court's order is inconsistent. This Court should make no such presumption. Neither the record before the trial court nor the court's comments during hearing sustain the false factual premise on which BDI's entire legal argument rests. Hence BDI's reliance upon *United States v. Arnold Schwinn & Co.*, 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1249 (1967), is misplaced.

2. BDI's Appeal Is a Disguised Attack on California's Fair Trade Laws.

BDI miscasts this case in terms of an attack on an alleged system of customer and territorial restrictions. It is not. On the basis of the relief it seeks BDI challenges *only* a fair trade contract lawful under California state law. The Supreme Court has said:

> "Congress, however, in the McGuire Act has approved state statutes sanctioning resale price maintenance schemes such as those involved here. Whether it is good policy to permit such laws is a matter for Congress to decide. Where the statutory language and the legislative history clearly indicate the purpose of Congress that purpose must be upheld."
>
> *Hudson Distributors, Inc. v. Eli Lilly & Co.*, 377 U.S. 386, 394 84 S.Ct. 1273, 12 L.ed.2d 394 (1964)

BDI does not openly challenge Olympia's fair trade policy because it cannot. It did so in the trial court

without success [2 R.T. 38]. The trial court quite properly recognized that alcoholic beverages, including beer, are special commodities subject to stringent control. Passage of the Twenty-first Amendment placed this control in the hands of the several states.

See *State Board of Equalization v. Young's Market Co.*, 299 U.S. 59, 57 S.Ct. 77, 81 L.ed. 38 (1936);

Joseph E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35, 86 S.Ct. 1254, 16 L.ed.2d 336 (1966).

The California Alcoholic Beverage Control Act [Calif. Bus. & Prof. Code § 23000, et seq.], among other provisions, gives permission for fair trade pricing of alcoholic beverages. [Bus. & Prof. Code §§ 24749, 24750]. By definition beer is an "alcoholic beverage" [Bus. & Prof. Code § 23004].

The California Supreme Court has twice upheld the constitutionality of the Act's fair trade provisions.

Wilke & Holzheiser, Inc. v. Dept. of Alcoholic Beverage Control (1966) 65 Cal.2d 349.

Allied Properties v. Dept. of Alcoholic Beverage Control (1959) 53 Cal.2d 141.

Other California courts faced with attacks on fair trade agreements have likewise uniformly upheld them.

A.B.C. Distributing Co. v. Distillers Distributing Co. (1957) 154 Cal.App.2d 175 [Calvert specified prices at which wholesaler sold to retailers];

DeMartini v. Department of Alcoholic Beverage Control (1963) 215 Cal.App.2d 787 [resale fair trade upheld];

House of Seagram, Inc. v. M.C.F., Inc. (1962) 200 Cal.App.2d 774 [resale fair trade upheld].

See also 36 Op. Att. Gen. 277, 280.

The *A.B.C. Distributing Co.* case is clear authority for Olympia's fair trade contracts. Plaintiff was a wholesaler who distributed defendant Calvert's alcoholic beverages. Calvert had a fair trade agreement establishing prices to be charged by the wholesaler to retail licensees. When plaintiff's distributorship was cancelled, he charged an unlawful restraint of trade under the Cartwright Anti-Trust Law, and specifically charged "that at all times defendants have determined, declared and controlled the prices from time to time to be charged by them of their immediate purchasers and by their purchasers upon resale thereby by means of contract provisions, implied agreements, arrangements, recording, and causing the recording thereof, and by other means." [154 Cal. App. 175, 179]. Upholding a nonsuit, the court noted that "From the mere fact of Calvert's refusal to sell plaintiffs, no inference of unlawful agreement can arise for the reason that a producer 'may lawfully select his own customers,' [Citations]" and further expressly stated with respect to the fair trade agreement:

> "Further to show that Calvert did not act violative of either the federal or state trade act, it fixed no prices upon its product except those which it sold to plaintiff and the prices at which the latter sold to retailers. In its 1953 contract with plaintiff, it specified the retail prices to be charged by plaintiff to retailers should be in accordance with the Fair Trade Act of California. Such control by Calvert over resale prices to be charged by plaintiff is in accordance with the law. (Cal. Alcoholic Beverage Control Act, Bus. & Prof. Code, sections 24750, 24756.)" [154 Cal.App.2d 175, 190].

It is to avoid the impact of the McGuire Act [15 U.S.C. § 45] and the Miller-Tydings Amendment to the Sherman Act [15 U.S.C. § 1] that BDI disguises its

object, but the relief it seeks is revealing: it does not apply for a court order forbidding customer or territorial restrictions on resale; it attempts only to evade a constitutional agreement controlling prices. It has no legal basis to do so.

3. The Schwinn Case Does Not Control the Issues on This Appeal.

BDI places critical, indeed fatal reliance on *United States v. Arnold Schwinn & Co.,* 388 U.S. 365, 87 S.Ct. 1856, 18 L.ed.2d 1249 (1967). A close examination of that case is therefore necessary.

In *Schwinn* the court had before it a defendant manufacturer who "had been 'firm and resolute' in insisting upon observance of territorial and customer limitations". 18 L.Ed.2d at 1256. The court held that such limitations in the context of consignment and agency arrangements were subject to the rule of reason (e.g. *White Motor Co. v. United States,* 372 U.S. 253, 83 S.Ct. 696, 9 L.ed.2d 738 (1963)) and, so viewed, were not unreasonable. 18 L.Ed.2d at 1261. The court *held further* that such limitations, where the manufacturer sold the product to its distributor violated Section 1 of the Sherman Act [15 U.S.C. Sec. 1] *per se.* 18 L.ed.2d at 1262. In so doing the court nevertheless recognized both the propriety of customer selection (e.g. *United States v. Colgate & Co.,* 250 U.S. 300, 39 S.Ct. 465, 63 L.ed.992 (1919) *and* the legality of price fixing *permitted by statute.* 18 L.ed.2d at 1258.

Thus *Schwinn* turns on two factors not present here: a *system* of enforced territorial and customer restrictions; and *acts in furtherance* of that system. Olympia, has already invited the court's attention to those comments of the trial judge negating any conclusion that Olympia maintained unlawful limitations or acted to

protect a system of customer or territorial restrictions. These lacunae in BDI's case make its reliance on *Schwinn* meritless: as already stated this is *not* a *Schwinn* case. Both fact and causation are missing.

This brief will not be extended by lengthy comment on the conspiracy cases which BDI cites. E.g. *United States v. General Motors Corp.,* 384 U.S. 127, 86 S.Ct. 1321, 16 L.ed.2d 415 (1966); *American Tobacco Co. v. United States,* 328 U.S. 781, 66 S.Ct. 1125, 90 L.ed. 1575 (1946). The trial court made no finding of conspiracy. If anything is clear from the record, it is that Olympia does not kowtow to its distributors in making business decisions [e.g. Hannah depos. pp. 154-58].

Nor need the "statutory exception" cases be dealt with. They too are beside the point. Whatever may be the rule when one uses a statutory exemption to violate the antitrust laws, that rule will not apply if one does not violate the law. Therefore Olympia will not extend this brief to comment individually on each authority cited by BDI. Instead reference will be made only to two cases involving fair trade.

United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 64 S.Ct. 805, 88 L.ed. 1024 (1944) involves a price fixing conspiracy which the defendant only partly cured by fair trading. The injunction against fair trade — issued only after trial on the merits and at the instance of the United States, not a private litigant — significantly lasted six months only. Defendant was clearly invited to renew its fair trade contracts once its price-fixing violations were cleared up. BDI's brief makes it clear it would not be satisfied with this sort of relief.

United States v. Frankfort Distilleries, 324 U.S. 293, 65 S.Ct. 661, 89 L.ed. 951 (1945) is an instance of criminal sanctions against a horizontal price-fixing con-

spiracy. The Supreme Court said only this was not covered by the Miller-Tydings Amendment or the McGuire Act [15 U.S.C. Sec. 1, 45].

BDI cites no case for the proposition that a fair trade contract can be struck down for the sole reason that it decreases competition. This is one obvious result of such contracts. BDI's sole complaint is that, because it offers less value for the customer's dollar, it cannot successfully compete. Nothing in *Schwinn* or any other authority cited guarantees an inadequate competition a place in the market.

Given the present posture of the case, the court must make certain assumptions; namely, that Olympia acted in the exercise of its independent business judgment without conspiring with any other party in undertaking a wholesale policy of fair trade pricing, and that in doing so it did not act to further any scheme of territorial or customer restrictions violative of Section 1 of the Sherman Act. Given these assumptions, this court is then confronted with the following single, narrow issue:

> *Does United States v. Arnold, Schwinn & Co. preclude reliance by a manufacturer upon a statutorily authorized pricing scheme whereby independent distributors purchase from the manufacturer at the same price, resell the product at the same price to retailers who, in turn, sell the product at the same price wherever and to whomever they choose.*

Olympia submits that it does not.

4. BDI has made no case for injunctive relief.

It is obvious that injunctive relief, particularly in the context of an antitrust suit and particularly at a preliminary stage in the proceedings is a serious and heavy remedy to grant a complaining party. To grant

an injunction the trial court should have been satisfied (1) that the case warranted extraordinary treatment, (2) that the decree sought by BDI would not alter the status quo, (3) that the decree would not have the effect of regulating an entire industry, and (4) that BDI would not suffer irreparable harm if the decree were denied. As already pointed out, the court below was satisfied on none of these points [2 R.T. 40-42].

As expressed in the leading case of *Warner Bros. Pictures v. Gittone,* 110 F.2d 292 (3rd Cir. 1940) at 293:

> "We have pointed out frequently that the granting of a preliminary injunction is an exercise of a very far-reaching power, never to be indulged in except in a case clearly demanding it. [Citations] To justify the granting of such an injunction there must be a showing of irreparable injury during the pendency of the action. [Citations] It must also appear that the injunction is required to preserve the status quo pendente lite." 110 F.2d 292, 293.

Furthermore:

> "At this stage of the proceedings the Court is governed by the familiar rule that preliminary injunction should be viewed with caution and only granted in those clear cases where there is a substantial probability of eventual success." *John J. & Warren H. Graham v. Triangle Publications, Inc.* (E.D. Pa. 1964) 233 F.Supp. 825, 829, aff'd *Graham v. Triangle Publications, Inc.* (3 CA 1965) 344 F.2d 775.
>
> See also *Alpha Dist. Co. of California v. Jack Daniel Distillery,* 304 F.2d 451 (9th Cir. 1962).

The trial court entertained considerable doubt as to the merits of BDI's complaint [2 R.T. 49]. This in itself

is grounds for denying the extraordinary relief sought. BDI did not carry its burden of proof.

Graham v. Triangle Publications, Inc., supra;

Paramount Pictures Corporation v. Holden, 166 F. Supp. 684 (S.D. Calif. 1958);

Automatic Radio Manufacturing Co. v. Ford Motor Co., 242 F.Supp. 852 (D. Mass. 1965);

Deltown Foods, Inc. v. Tropicana Products, Inc., 219 F.Supp. 887, 891 (S.D.N.Y. 1963);

See *Hershel California Fruit Products Co. v. Hunt Foods, Inc.,* 111 F.Supp. 732, 733 (N.D. Calif. 1953).

Moreover, the lower court was properly reluctant to resolve the ultimate factual issues on which this case turns [2 R.T. 49]. This too is a proper ground to deny the injunction sought.

Paramount Pictures Corporation v. Holden, 166 F.Supp. 684, 691 (S.D. Calif. 1958);

Alpha Dist. Co. of California v. Jack Daniel Distillery, 207 F.Supp. 136 (N.D. Calif. 1961) aff'd 304 F.2d 451 (9th Cir. 1962);

George W. Warner & Co. v. Black & Decker Manufacturing Company, 167 F.Supp. 860 (E.D. N.Y. 1958); summary judgment granted 172 F.Supp. 221 (E.D. N.Y. 1959), rev'd 277 F.2d 787 (2d Cir. 1960);

Lowe v. Consolidated Edison Co., 67 F.Supp. 287 (S.D. N.Y. 1941).

And, as was said in *Hershel California Fruit Products Co. v. Hunt Foods, Inc.,* 111 F.Supp. 732 (N.D. Cal. 1953), at 734:

> "The preservation of status quo should not be confused with the economic stabilization of a whole industry, as compared with the restoration or attempted restoration of competition within such industry."

Most importantly, BDI has shown no irreparable injury. For this reason alone the injunction could not issue.

Graham v. Triangle Publications, Inc., supra;

Gerber Products Co. v. Beech-Nut Life Savers, 160 F.Supp. 916 (S.D. N.Y. 1958).

Although BDI invites this court to treat this appeal as a trial de novo, clearly the lower court's view of BDI's damage and Olympia's design, motive or intent are not matters open to such review.

United States v. Yellow Cab Co., 338 U.S. 338, 70 S.Ct. 177, 94 L.ed. 150 (1949).

See: 5 Moore, *Federal Practice* 2616, ¶ 52.03[1] (and cases cited at n.26).

The cases relied upon by BDI simply do not rebut the foregoing standards of judicial conduct. None concern the case, as here, where all key factual issues have been decided against the applicant. So much of BDI's application as sought to enjoin enforcement of the fair trade contract was properly denied.

OLYMPIA'S OPENING BRIEF ON CROSS-APPEAL

V

STATEMENT OF ERRORS

1. The trial court in seeking to preserve the status quo erred by issuing an injunction to enforce a contract which did not exist and was not specifically enforceable.

VI

SUMMARY OF ARGUMENT

The trial court sought to maintain what it understood to be the status quo between the parties, namely, a course of dealing extending back over 15 years. By doing so, it in effect wrote a new contract between the parties and gave specific performance to an agreement which did not exist. This lay beyond its power.

VII

ARGUMENT

1. The Trial Court Recognized BDI Had No Right to Expect a Continuing Relationship With Olympia.

On the basis of the trial court's comment during the hearing, it is clear that the court issued a preliminary injunction, after first inviting a stipulation from the parties to the same effect, solely for the purpose of maintaining a situation in statu quo. Olympia recognizes that it is confronted with something of the same dilemma facing BDI, namely, the lack of specific findings in the record before this Court establishing the basis on which the court continued the temporary restraining order in effect. However, the court's comments during the course of the hearing indicate several things.

(1) The court did not consider that continuing the temporary restraining order, which envisages fair trade sales, would damage Olympia because it would place BDI on an equal footing with other Olympia distributors [2 R.T. 34].

(2) The court did not think that BDI showed a contract of distribution [2 R.Tr. 35]. Thus the court accepted Olympia's position — not seriously refuted by BDI — that the relation between the parties was on a

sale-by-sale basis subject to termination at will [R. 203-204].

(3) Olympia's decision to terminate its relationship with BDI was not the result of any conspiracy or in furtherance of any scheme to protect an illegal system of distribution. It was made "for the reason that plaintiff brought this suit [2 R.Tr. 31].

It will be apparent that the court in issuing its order was dealing with a matter of contract and not a matter of the antitrust laws. It has already been indicated that the court did not reach the conclusions critical to BDI's appeal, namely, that an illegal territorial system had been established or that any conduct of Olympia was directed toward protecting such system, if there were one. Hence the court's order should be viewed simply in terms of the attempted enforcement of a particular relationship between the parties.

2. The Trial Court Erred by Enforcing an Agreement Which Does Not Exist.

Although it does not concede it, Olympia is prepared to assume for the purposes of this appeal that it will not suffer irreparable damage by continuance of the preliminary injunction until trial. Nevertheless, an injunction should not have been issued to preserve the status quo because the arrangement between the parties is not one susceptible of specific enforcement. This very proposition was recognized in *Alpha Dist. Co. v. Jack Daniel Distillery,* 207 F.Supp. 136 (N.D. Cal. 1961) aff'd 304 F.2d 451 (9th Cir. 1962). To the same effect is *A.B.C. Dist. Co. v. Distillers Dist. Corp.,* 154 Cal.App.2d 175 (1957).

Olympia is entitled to a free choice of distributors under both California [Bus. & Prof. Code § 25007] and

federal law [*United States v. Colgate & Co.,* 250 U.S. 300, 39 S.Ct. 465, 63 L.ed. 992 (1919)]. Dissatisfaction with a litigious distributor is an entirely proper basis for termination. *House of Materials, Inc. v. Simplicity Pattern Co.,* 298 F.2d 867 (2d Cir. 1962).

Indeed BDI recognizes that its relation with Olympia was terminable at will without cause. In its Supplement to Complaint, the only condition of termination which BDI alleges is reasonable notice [R. 39]. This is the classic basis for an award of damages, if proved, not injunction.

This precise factor was recognized by *Warner v. Black & Decker Mfg. Co.,* 167 F.Supp. 860 (E.D. N.Y. 1958) where injunction pendente lite was *denied.* A lengthy discussion of the question is set out at 167 F.Supp. 863-64. It is submitted the conclusion of the learned trial judge in that case should have been applied by the court here: it is *not* enough that Olympia may suffer no harm before trial to warrant issuance of a preliminary injunction. There must be an arrangement between the parties which can be specifically enforced. Here there is none. If BDI prevails at trial it is entitled to money damages only. For this reason the trial court erred in issuing an order that Olympia continue to deal with BDI pending trial. The court in effect is enforcing an agreement which does not exist. This it cannot do.

CONCLUSION

Neither the state of the record nor any "findings" of the district court sustains the critical assumptions made by BDI in its appeal. The court did not accept as true that Olympia maintained any system of territorial or customer restrictions proscribed by the antitrust laws of the United States. Nor did it conclude that Olympia's action in instituting a fair trade policy or in terminating BDI as a distributor was the result of an attempt to maintain such a system. The court's action was one turning on the relationship between the parties as manufacturer and distributor extrinsic of antitrust considerations. Therefore the court properly denied the application to enjoin Olympia's fair trade policy. But it gave BDI a status it had not enjoyed before the hearing by requiring Olympia to continue sales to BDI pending trial. This much of the court's order should be vacated.

Respectfully submitted,

Lillick, McHose, Wheat,
Adams & Charles

By John C. McHose

Attorneys for Olympia Brewing Company

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

By _____
John C. McHose

APPENDIX A

Portions of the Affidavit of David Brice Toy dated September 28, 1967.

At pp. 1-2:

STATE OF CALIFORNIA
CITY AND COUNTY OF
SAN FRANCISCO } ss.

David Brice Toy, being first duly sworn, deposes and says of his own knowledge as follows:

1. He is an attorney associated with the firm of Lillick, McHose, Wheat, Adams & Charles who are attorneys for defendant Olympia Brewing Company herein.

2. On July 19, 1966, he attended at the continued deposition of Charles Hammond Jones, taken in the case of "Thriftimart, Inc. vs. Beverage Distributors, Inc., et al.," case number 863,340 in the Los Angeles Superior Court. Both Beverage Distributors, Inc. (BDI) and Olympia Brewing Company (Olympia) were and are defendants in that suit.

3. At that deposition Mr. Jones, who identified himself as vice president and manager of BDI's Southern California division, gave the following testimony under oath:

at p. 10:

Q "Have you or anyone from BDI, ever contacted Olympia with respect to a desire to effect sales to others than Safeway?

A I haven't, no. To my knowledge, I don't know whether anyone else has.

Q So far as you know, no one else has? Is that what you are saying?

A I am saying I just don't know. I haven't been present at the meetings between, say, Mr. Morton and Olympia representatives in San Francisco; so, I wouldn't know if the subject were discussed.

Q Did Mr. Morton ever tell you that he had discussed it with anyone from Olympia?

A He hasn't, no.

Q Have you ever seen any memorandum indicating that Mr. Morton, or anyone else from BDI, had discussed the possibility of sales to others with Olympia?

A No, I haven't."

at pp. 12-16:

Q Do you know Mr. Arthur Halgren?

A Yes.

Q Except for the conversation of July 3, 1958, to which you have already testified, have you or anyone at BDI ever discussed the question of distribution of Olympia beer to anyone other than Safeway in California with Mr. Halgren?

A I can't recall any specific conversation. This could have been discussed, but I don't recall any.

Q Do you recall Mr. Morton ever relating a conversation he might have had with Mr. Halgren to you?

A I don't recall any.

Q Do you know whether or not in your corporate records there are any memoranda of such a conversation between anyone at BDI and Mr. Halgren?

A I don't know of any, no.

Q Do you know Mr. Harry Moore?

A Yes.

Q Have you ever had a discussion on the same subject matter with Mr. Moore since 1958?

A I don't recall any discussions with Mr. Moore about it, no.

Q Do you know if anyone else from BDI has had such a discussion with Mr. Moore?

A None that I know of.

Q If such a discussion with Mr. Moore were to be had, who at BDI would be likely to have had it?

A It would have probably been me.

Q Do you know Mr. Thomas Morgan?

A No, I don't.

Q Do you recall any conversations with any other employees of Olympia, except Mr. Halgren, Mr. Moore, or Mr. Morgan, between yourself and such employees, respecting the questions of sales by BDI to Thriftimart of Olympia beer since 1958?

A No, I can't recall any.

Q Do you recall Mr. Morton's ever relating any conversation with other employees which he might have had to you?

A No, I can't.

Q Do you know whether there are any memoranda in the company files now relating to such conversation?

A I am not aware of any.

At page 209, l.20 to page 211, l.14:

Q BY MR. TOY: Who establishes BDI's price for retail resale of Olympia beer in California, Mr. Jones.

A As of now?

Q As of now?

A I do.

Q Did Mr. Morton establish it before his death?

A Yes.

Q Is there any agreement between BDI and Olympia respecting the price at which BDI sells its beer?

A No, there isn't.

Q Are you aware of any conversations or discussions between 1958 and the present date between representatives of BDI and representatives of Olympia regarding the price at which BDI sells Olympia beer?

A I don't know of any, no.

Q Has Olympia ever indicated to you in writing or otherwise its dissatisfaction with the pricing arrangements made by BDI for sale of Olympia beer?

A No.

Q Does BDI have any arrangements with Olympia respecting the territory in which it is to sell Olympia beer?

A We sell it in all of the areas in which we are licensed to operate, which is California, Arizona and Nevada.

Q That's throughout the State of California?

A Yes.

Q Except insofar as such an arrangement is set out in the 1958 exchange of correspondence to which you have already testified, does BDI have any other arrangement or agreement with Olympia respecting the customers to whom BDI may sell Olympia beer?

A That is the only arrangement or agreement concerning customers that I know of.

Q So far as you are aware, are there any unwritten or oral arrangements or agreements respecting customers?

A None beyond the ones we have mentioned, the written —

Q The two letters?

A Yes.

Q Now, in his questioning, Mr. Lydick went into Mr. Murrell's affidavit of July 20. Have you got a copy of that now in hand?

[Colloquy of counsel]

At page 212, l.1 to page 213, l.7:

Q BY MR. TOY: I am referring now to Page 9 of Mr. Murrell's affidavit. I think Mr. Lydick read this particular sub-paragraph to you earlier, Mr. Jones. It says, "On September 17, 1964, Declarant telephoned Charles Jones of BDI and asked why Thriftimart had not received delivery of the six different carloads ordered on July 23, 1964."

Earlier in the affidavit Mr. Murrell says that Thriftimart placed a registered mail order for various beers, including Olympia.

Mr. Jones replied that, "The orders had been sent to BDI's San Francisco office. Declarant then asked Mr.

Jones if the brewers had refused to allow BDI to fill the orders to Thriftimart. Mr. Jones replied I would rather not say"?

Q Had Olympia in fact, as of September 17, 1964, refused to allow BDI to fill the orders to Thriftimart?

A I don't know whether they were passed on to Olympia or not; copies of those orders.

Q Did Mr. Morton ever tell you that copies of the orders had been sent to Olympia?

A It was my understanding that Thriftimart mailed the orders, or a copy of the orders, to each of the brewers involved.

Q Did you ever have any discussions yourself with representatives of Olympia respecting these orders?

A No. I didn't.

Q Do you know if Mr. Morton ever had such a conversation?

A I don't know.

Q Did he ever report such a conversation to you?

A He didn't.

No. 22364 and A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellant,

vs.

OLYMPIA BREWING COMPANY,
a corporation,

Appellee.

OLYMPIA BREWING COMPANY,
a corporation,

Appellant,

vs.

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellee.

Appeal from the United States District Court for the Northern District of California

REPLY BRIEF OF CROSS-APPELLANT OLYMPIA BREWING COMPANY

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ERRATUM

In its answering brief, p. 1, Olympia referred to its answering argument as appearing in Section V of the brief and to its opening argument as appearing in Section VIII. These references should have been to Sections IV and VII respectively.

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REPLY BRIEF OF CROSS-APPELLANT OLYMPIA BREWING COMPANY

I

INTRODUCTION

By its cursory response to Olympia's argument on cross-appeal, BDI has attempted to minimize the significance of what it labels "the limited injunction which the Court did grant." [BDI Ans. Br. 19.] Rather than meet the only issue involved, i.e. whether the extraordi-

nary remedy of preliminary injunction was proper relief on the facts presented, BDI skirts the obvious answer by throwing out two red herrings: *first*, that Olympia was not entitled to terminate relations with a customer in furtherance of conduct which violates the antitrust laws; and *second*, that Olympia will not suffer irreparable damage by continuance of the preliminary injunction until trial. [BDI Ans. Br. 19.] Neither of these propositions, Olympia submits, is relevant, supported by the evidence, or persuasive.

What is, on the other hand, of critical importance is the nature of the relationship between Olympia and BDI. For, just as in *Scanlon v. Anheuser-Busch, Inc.*, 1968 TRADE CASES, para. 72,355 (9th Cir. 1968), recently decided by this Circuit, that relationship was one terminable at the will of either party. [2 R.T. 35]. The trial court in effect wrote a new contract for the parties and invested BDI with a status never previously enjoyed by it and not presently enjoyed by any other distributor of Olympia beer in California.

As a result, the court's order amounted to a mandatory direction that Olympia continue supplying a distributor with whom it had an arrangement without tenure, by whom its servicing and merchandising policies were not satisfactorily pursued, and in whom it had lost confidence. Such an order exceeded proper exercise of the equitable powers of the court in this type of case, and should not be allowed to stand.

II

ARGUMENT

1. The order-to-order arrangement between Olympia and BDI is terminable at will and not amenable to specific enforcement or mandatory injunction.

As Olympia's letter recognizing and welcoming BDI as one of its distributors makes clear [R. 208], there is no relationship between the parties for which any consideration or value was exchanged. BDI was simply recognized as a wholesaler whose requests for supplies of Olympia beer would be reviewed and filled on an order-by-order basis. No right to continue to distribute Olympia beer was acquired by BDI, and conversely, Olympia acquired no right to prevent BDI from discontinuing its Olympia distribution. As nothing was purchased by BDI, in the event of termination it had nothing to sell. In short, as the trial court recognized, there is no contract of distribution. [2 R.T. 35].

The effect of this is twofold. Where the distributor has no tenure, enjoining termination necessarily requires the performance of affirmative and continuing acts which could not properly be specifically enforced. See *Alpha Distributing Company of California, Inc. v. Jack Daniel's Distillery*, 207 F. Supp. 136 (N.D. Cal. 1961) aff'd 304 F.2d 451 (9th Cir. 1962); *Long Beach Drug Co. v. United Drug Co.*, 13 Cal.2d 158 (1939). Clearly distinguishable are such cases as *F. K. Weingartner v. Union Oil Co. of California,* 1966 TRADE CASES, para. 71,757 (N.D. Cal. 1965), cited by BDI, in which a preliminary injunction operates to preserve, pendente lite, an *existing contractual relationship.* The order-to-order relationship between these parties makes it impossible for BDI to show any facts which could support either specific performance or injunction. *Makel Textiles, Inc. v. Pellon*

Corp., 1964 TRADE CASES, para. 71,241 (S.D.N.Y. 1964); *Alpha Distributing Co. of Cal. v. Jack Daniel's Distillery,* supra.

Whether *Olympia* will or will not be irreparably damaged is beside the point [BDI Br. 19]. BDI cannot show its right to the relief granted. The relationship between the parties gave Olympia the right to effect termination at any time within its discretion.

More significantly, however, the fact that the relationship between the parties is terminable at will emphasizes the appropriateness of a remedy at law for damages and the impropriety of injunctive relief before trial on the merits. As BDI apparently concedes [Suppl. to Complaint, R. 39], the only legitimate inquiry upon termination of such a relationship is whether reasonable notice should have been or was given. *Alpha Distributing Co. of Cal. v. Jack Daniel's Distillery,* 207 F. Supp. 136, 138 (N.D. Cal. 1961) aff'd 304 F.2d 451 (9th Cir. 1962); *Millett Co. v. Park & Tilford Distillers Corp.,* 123 F. Supp. 484 (N.D. Cal. 1954). This issue affects the question of money damages only.

2. Olympia should not be required by preliminary injunction to supply a distributor in whom it has lost confidence.

Because the arrangement between Olympia and BDI was from its inception terminable at will and for any cause, Olympia is not required to justify its refusal to fill BDI's orders. *Scanlan v. Anheuser-Busch, Inc.,* 1968 TRADE CASES, para. 72,355 (9th Cir. 1968); *Ace Beer Distributors, Inc. v. Kohn, Inc.,* 318 F.2d 283 (6th Cir. 1963), cert. denied 375 U.S. 922 (1963), reh. denied 375 U.S. 982 (1963). A manufacturer has the right to select its customers and to refuse to sell its goods to anyone, for

reasons sufficient to itself, so long as an unreasonable restraint of trade does not result. *Ace Beer Distributors, Inc. v. Kohn, Inc., supra; United States v. Colgate & Co.,* 250 U.S. 300 (1919).

Both *Scanlan* and *Ace Beer* demonstrate that termination of a beer distributorship in a competitive market, with no effect on the availability of competing products, is neither an unusual business procedure nor an unreasonable restraint of trade in violation of the Sherman Act.

But Olympia submits in addition that its termination of BDI was amply justified under the special circumstances of their relationship. For, as reiterated in the *Scanlan* opinion, " 'the anti-trust laws do not require a business to cut its own throat.' " [*Brown v. Western Massachusetts Theaters, Inc.,* 288 F.2d 302, 305 (1st Cir. 1961) quoted with approval in *Scanlan v. Anheuser-Busch, Inc.,* 1968 TRADE CASES, page 84,964.]

The relationship between a brewer and its distributors must necessarily be a close and personal one, dependent upon mutual trust and confidence. [Hannah affidavit, R. 204]. The peculiarly volatile nature of the commodity puts a premium on efficient handling and servicing, while the highly competitive nature of the market makes proper merchandising essential. The enthusiastic support and co-operation of the distributor is key to the manufacturer's possibility of success. [Comments by the trial court, 2 R.T. 23-25].

Such a relationship of confidence and co-operation became impossible once BDI filed suit. [Hannah affidavit, R. 204-5].

BDI's attempt to divert the justification for termination from Olympia's loss of confidence to resentment over

its new order finds no support in the record. The trial court clearly recognized that Olympia's decision was an independent one and treated it as separable from the question of fair trade.

Because Olympia had not undertaken to terminate BDI before its receipt of the new orders has no significance at all. After BDI filed suit, but prior to these orders, Olympia reasonably assumed that BDI had abandoned distribution of its beer. [Hannah depo. 127]. It was not until receipt of the new orders that Olympia had occasion to exercise its customary right of review on a sale-by-sale basis. Presented with them, Olympia justifiably determined that it should no longer recognize BDI as one of its distributors.

Contrary to the argument of BDI, this determination is consistent with the rationale of *Bergen Drug Company v. Parke, Davis & Company,* 307 F.2d 725 (3rd Cir. 1962), where it was found that the relationship between the parties has been *impersonal* and the product a non-sensitive one requiring no facility in handling or merchandising. Such factors preclude application of *Bergen* to this case. Here service is of the essence. It would be unreasonable and unwarranted to expect Olympia to entrust the marketing of its product to a vexacious distributor. Certainly such risk should not be imposed by preliminary injunction. *Alpha Distributing Co. of Cal., Inc. v. Jack Daniel's Distillery,* 207 F. Supp. 126, 138 (N.D. Cal. 1961) aff'd 304 F.2d 451 (9th Cir. 1962).

Albrecht v. The Herald Company, ...U.S....., 19 L.ed.2d 998 (1968) is no comfort to BDI in this regard. Despite a passing reference to plaintiff's termination "in response" to the filing of an antitrust suit [19 L.ed.2d 1001; BDI Br. 15], it is clear that the decision turned on the Court's finding of a combination to fix resale prices

of newspapers, illegal per se under the Sherman Act. The Herald's refusal to deal was infected with the vice of resale price fixing, and not surprisingly, was viewed with disfavor. On the other hand, the trial court here has made no finding that BDI was terminated in furtherance of a price fixing conspiracy. Indeed, Olympia's fair trade policy is expressly permitted under State law and therefore sanctioned by the Sherman Act. [Olympia Br. 13-14]. Neither *Albrecht* nor *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) impairs the vitality of *Colgate* on the facts of this case.

Finally it should be noted that *Albrecht* arose only after full jury trial on the merits, and its very posture as an action for damages is persuasive that BDI's remedy, if any, should properly lie at law and not in equity.

CONCLUSION

Because Olympia had dealt with BDI only on an order-to-order basis under an arrangement terminable at the will of either party, it was entitled to terminate that relationship at any time without cause. The relationship is inherently incapable of specific enforcement, and accordingly should not be subject to preliminary injunction. An adequate, and indeed the only proper remedy is available at law after full trial on the merits. Olympia therefore respectfully submits that it be relieved from continuing to supply a distributor no longer meriting its confidence.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

By.....
John C. McHose

No. 22364 and A

In the

United States Court of Appeals

For the Ninth Circuit

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellant,

vs.

OLYMPIA BREWING CO.,
a corporation,

Appellee.

OLYMPIA BREWING COMPANY,
a corporation,

Appellant,

vs.

BEVERAGE DISTRIBUTORS, INC.,
a corporation,

Appellee.

On Appeal from the United States District Court
for the Northern District of California

Reply Brief of Beverage Distributors, Inc., as Appellant and Answering Brief on Cross-Appeal

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SUBJECT INDEX

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INTRODUCTION

This appeal, based entirely upon documentary evidence, permits this Court an unusual opportunity to give that "prompt and effective"[1] justice which eminent jurists have so stressed as of crucial importance. In words unfortunately applicable to this plaintiff, Chief Justice Warren has recently pointed out, in

1. 42 F.R.D. at 265. See also 29 F.R.D. 191 *et seq.*

criticism of the delays, congestion and frustrations of the judicial process:

> ". . . the client who cannot afford to wait for years for a judgment in the trial court suffers great injustice even if he eventually prevails."[2]

The thrust of Olympia's brief is toward delay. It commends to this Court a reluctance to resolve the factual issues (Olympia brief, page 19) and seeks, often without reference to the record, to reargue facts which Olympia once conceded (*infra* at p. 3). Therefore, we have largely devoted this brief to a showing that there is no basis for dispute as to the facts or the law.

SUMMARY OF ARGUMENT

Olympia's illegal territorial and customer restrictions are clearly proven not only by Olympia's established boundary lines, but also by its directions to distributors to stop competing in the few instances in which competition has occurred (*infra* at p. 4). Although now disputed by counsel for Olympia, there can be no serious question that Olympia adopted a fair trade program to frustrate BDI's efforts, in compliance with the *Schwinn* decision, to break into the exclusive territories (*infra* at p. 6). Nor can there be a doubt that the same illegal purpose prompted the immediate termination of BDI when it did succeed in breaking the barriers (*infra* at p. 13). Respect for California's fair trade laws should not justify refusal of injunctive relief against their use by Olympia to achieve a purpose illegal under the Sherman Act (*infra* at p. 16). They are dishonored by Olympia's misuse of them; not by the prevention of such misuse. BDI's detailed factual evidence of irreparable injury has been completely ignored in Olympia's brief (*infra* at p. 17).

ARGUMENT

1. Olympia's Recorded Admissions Prove It Used Fair Trade to Violate the Sherman Act.

Since the record is entirely a documentary one without findings, and since the issue as to Olympia's illegal purpose depends upon the effect of admissions of Olympia's own officers on deposition,

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2. Chief Justice Earl Warren: *The Administration of the Courts,* 51 JUDICATURE 196, 200 (January 1968).

this Court will make an independent determination of the legal conclusions and inferences from those admissions. *Fleischmann Distilling Corp. v. Maier Brewing Company,* 314 F.2d 149, 152 (9 Cir., 1963):

> " 'When a finding is essentially one dealing with the effect of certain transactions or events, rather than a finding which resolves disputed facts, an appellate court is not bound by the rule that findings shall not be set aside, unless clearly erroneous, but is free to draw its own conclusions.' *Stevenot, v. Norberg,* 9 Cir., 210 F.2d 615, 619."

a. The testimony of Olympia's own officers establishes conclusively that Olympia has enforced an illegal system of territorial and customer restrictions.

The bald assertions by counsel that BDI did not prove territorial restrictions (Olympia brief, pages 9, 15) are overwhelmingly belied by the unimpeachable admissions to the contrary by Olympia's officers. Before the Court is the admission of Olympia vice president Thomas L. Morgan in an affidavit dated September 23, 1965 (R. 43):

> "Olympia Brewing Company has authorized each of its distributors to sell Olympia beer in well defined geographical areas which are not overlapping, and in that manner Olympia beer is available to the various retail accounts in all marketing areas."

Olympia sales director Phil Hannah admitted on July 27, 1967, that this statement by Mr. Morgan remained "substantially true" (R. 43). The only exceptions to this policy of territorial limitations were BDI (which could sell to Safeway stores only (*infra* at p. 5)) and a distributor which sells to Thrifty Drug Stores' central warehouse (R. 45). Olympia's maps which have been introduced in evidence clearly define the distributors' areas (Exhibits 1, 2). Olympia's sales director freely admitted that these maps designate distributors' areas (R. 46-52). Counsel's assertions to the contrary are completely unsupported by any substantial evidence in the record. As proof of its contrary assertion that "Olympia's distributors have complete freedom in selecting to whom and where they make sales" (Olympia brief, page 3), Olympia is only able to cite the following: (1) a general, undocumented self-serv-

ing affidavit of Olympia's president, conclusory in character and without reference to any specifics (R. 222-223); (2) a self-serving affidavit of an Olympia distributor, citing as proof his decision not to sell to BDI *after* Olympia had terminated BDI (R. 196-197); (3) Mr. Hannah's testimony of his conversation with the same distributor (Exhibit 4, Hannah deposition, pages 104-105):

> "A. . . . He wondered why he had received it, and I said we were no longer selling BDI. He said, well, you know what I'm going to do with this order. I am going to put it in the wastebasket. He didn't ask me what to do with it whatsoever.
>
> Q. Was there any other discussion between you and him on that subject?
>
> A. By this time, I think, I'm sure I told him of the suit filed against us by BDI."

The most that Olympia can glean out of that evidence is that after Olympia terminated BDI its other distributors were "free" to decide not to sell to BDI. That is what they all did, after talking to Olympia (Exhibit 14; Exhibit 3, pages 29-33).

Olympia's brief goes on to refer to "a variety of instances in which Olympia distributors were making sales beyond their areas of responsibility [Exhibit 4, Hannah deposition, pages 16-30, 216] without any reprisal or threat on Olympia's part [R. 44-45]" (Olympia brief, page 3). The cited testimony of Mr. Hannah at pages 16 to 25 of his deposition proves exactly the contrary. Mr. Hannah, Olympia's sales director, testified that he received a report that two distributors were delivering to the same area near Saugus, California (Exhibit 4, page 19). Mr. Hannah then "called up to establish who had been in there originally the longest" (*ibid.*). Mr. Hannah told the distributors that they could not both be calling on the same accounts (*id.* at 22, 24) and told them to solve it by establishing a boundary line (*id.* at 23-25). He said, "We suggested they all sit down and settle it one way or another, because this is economic idiocy" (R. 50). The cited testimony of Mr. Hannah at pages 26 to 28 of his deposition proves another instance which is directly contrary to the proposition cited by coun-

sel for Olympia: Mr. Hannah received a report from an Olympia salesman that two Olympia distributors were competing for sales in a newly developed area (*id.* at 26-27). The two distributors were told that only one of them should stay in the area (*id.* at 27-28). Other than the situation in mountainous areas where one distributor is permitted to sell "a very minimum number of accounts" in the winter and another in the summer, Mr. Hannah could think of no other instance in which there had been solicitation of one account by two or more different distributors at the same time (*id.* at 29).

Nor can counsel for Olympia be believed when they assert that BDI "was subject to neither customer nor territorial restrictions on its sales of Olympia in California" (Olympia brief, page 3). In his letter of July 28, 1958, to BDI, Olympia's vice president in charge of sales stated (R. 70):

> "In regard to the third and fourth paragraphs of your letter, we would at the present time desire to hold yourself to your indicated commitment not to sell our product to anyone but Safeway. If you should desire to effect sales to others than Safeway, please immediately contact us so that we may review the whole situation.
>
> "Historically, as you are undoubtedly aware, going back for almost half a century, it has been the policy of our company to effect distribution of its product through independent distributors who have been assigned a geographical area for service. . . ."

How can counsel say, as they have dared to do (Olympia brief, page 4), that Olympia's letter quoted above merely acknowledged BDI's letter and that "it did nothing else" (*ibid.*).

Olympia President Schmidt testified that this restriction on BDI had never been removed (Ex. 5, p. 43). The admissions of Olympia's own officers permit only a finding that Olympia, like Arnold, Schwinn & Co., "has been 'firm and resolute' in insisting upon observance of territorial and customer limitations by its . . . distributors" (*United States v. Arnold, Schwinn & Co.,* 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1246 (1967)).

b. Olympia's own admissions establish conclusively that Olympia formulated the fair trade program and subsequently terminated BDI for the purpose of enforcing its illegal territorial and customer restrictions.

Olympia has again accused us of a misstatement (Olympia brief, page 6) in saying (BDI opening brief, page 7) that "Counsel for Olympia admitted in open court during the preliminary injunction hearing that Olympia fair traded for the purpose of making it 'difficult if not impossible for sales to be made by BDI' in competing with its method of distribution for Olympia business of its other customers (statement of David Toy, R.T., page 95)." We submit that the following concessions by counsel establish just such an admission (R.T. 93-95). Olympia's counsel first admitted that the following is a fair statement (R.T. 93):

> "MR PARKINSON: Let me put it the way we see it, if Your Honor please. I think it is clear, and they have admitted, that they fair-traded because of BDI's announcement that they were going to sell to others. . . ."
>
> "THE COURT: Well, do you concede that?
>
> * * * * * * *
>
> "MR. TOY: Stated that way, I think I might quibble with the words a little bit, Your Honor, but in substance that is a fair statement."

After careful clarification, Olympia's counsel then deliberately agreed to the following summary by the Court of his admission (R.T. 95):

> "THE COURT: All right. Then it seems to me your answer, to put it in somewhat different words, is that a primary or major consideration for fair-trading was to prevent BDI from selling at less than a wholesale fair-trade price to any central warehouse retailer, with the view that one of the effects of fair-trading would be to make it difficult if not impossible for sales to be made by BDI."

Since counsel for Olympia have now flatly denied making these admissions (Olympia brief, page 6), we have included the colloquy leading up to them as Appendix 1.

The actions and admissions of Olympia's officers, as well as the chronology of events corroborate Olympia's counsel's admissions. Olympia's timetable (Olympia brief, page 7), however, is misleading, since it conspicuously omits the fact that BDI's

letter announcing its intention to sell to customers other than Safeway was dated August 7th (R. 74), and that it was on August *8th* that Olympia decided to undertake its fair trade program (Exhibit 4, Hannah deposition, pages 65-66; R. 79-82). A more complete timetable follows:

Fall 1966—Theo. Hamm Brewing Co. instituted a wholesale fair trade program for its beer in California (Exhibit 4, Hannah deposition, page 38). Olympia president Schmidt concluded that Hamm's action was directed at BDI, which distributed Hamm's beer, as well as Olympia's, at central warehouse prices (Exhibit 5, Schmidt deposition, page 40; Exhibit 4, Hannah deposition, page 39). Hannah and his two assistants speculated that BDI would no longer be able to sell Hamm's beer to Safeway at Hamm's higher fair traded prices (Exhibit 4, Hannah deposition, page 47).

Fall 1966 - August 6, 1967—"Quite a number" of Olympia distributors inquired of Mr. Hannah from time to time whether Olympia had changed its position as to continuing to sell BDI (*id.* at 150-154). They asked specifically if Olympia were "looking at fair trading" (*id.* at 153-154). Mr. Hannah knew that "a substantial majority" of the Olympia distributors disliked BDI because they felt that BDI was "selling some very valuable customers in their area" (*id.* at 154):

> "In these conversations that you mentioned at the time of Anheuser-Busch termination of BDI and Hamm's fair trading, didn't anyone of these wholesalers say that they thought that Olympia ought to do the same?
>
> A. Yes.
>
> Q. They did?
>
> A. They said, 'Are you looking at fair trading specifically?' I think that was testified to. One of them specifically asked if we were going to at the time of Budweiser.
>
> Q. You understood that they were suggesting that Olympia should do the same thing?
>
> A. They didn't suggest, they asked.
>
> Q. They asked if Olympia was going to do these things?
>
> A. That is right.
>
> Q. Did they indicate whether or not they would like Olympia to do these things?

A. BDI is not going to win any popularity contest among the distributors down there.

Q. Why do you say that?

A. They feel they are selling some very valuable customers in their area.

Q. Is this feeling a general feeling from your knowledge of the market?

A. This would be my feeling, yes, sir.

Q. Do you know whether or not it is shared by almost all of your distributors, or all of them?

A. I can't speak for all of them, but I can say a substantial majority."

As Olympia president Schmidt testified, from time to time during this period Mr. Hannah would come in off a sales trip saying "Man, did I catch hell from a distributor" for continuing to sell to BDI (Exhibit 5, Schmidt deposition, page 37). On these occasions, Mr. Schmidt testified that the idea of terminating BDI and that of fair trading, as Hamm had done, "normally became part of the discussion, as ways and means in which to handle the situation" (*id.* at 38).

August 7, 1967—BDI notified Olympia by letter (R. 74) and orally through Olympia's counsel (R.T. 86) that BDI intended to sell Olympia beer not only to Safeway, but also to the central warehouse customers to whom BDI sold other brands. Mr. Hannah admits that the receipt of this notice from BDI was the occasion for Olympia's discussions on August 7 and 8, 1967, which led to the decision to fair trade (Exhibit 4, Hannah deposition, pages 49-50). Sales director Phil Hannah recommended that BDI be terminated. In support of that recommendation, he said (Exhibit 4, page 142):

> "I believe that a further extension of this Central Warehousing would be disastrous to us and the state is tremendously important to us. My recommendation was to take the first loss the quickest."

Mr. Schmidt testified that they discussed three alternatives (Exhibit 5, Schmidt deposition, pages 56-57):

> ". . . There actually were, let me say, three alternatives that we felt now that this had come to pass, and one would

> be to continue as we were, two would be to fair trade in order to ensure an orderly marketing of our product, and three would be to cut them off entirely. I asked Mr. Hannah, and of course Mr. Huffine at the same time, what their thoughts were as far as the three alternatives, what would happen if we would cut them off, what would happen if we fair traded, and, of course, we knew what would happen if we sold as they had requested."

Mr. Schmidt testified further that "we are familiar enough with the fact that if BDI sold to these other customers our present distributors could very possibly be hurt" (Exhibit 5, Schmidt deposition, page 69). Appendix 2 contains Mr. Schmidt's further testimony revealing his concern as to the effect on Olympia's distributors if Olympia had decided to take no action (*id.* at 58-60).

The fair trade program was decided upon in preference to Mr. Hannah's recommendation to cut BDI off entirely (Exhibit 5, Schmidt deposition, page 62). Since no one other than BDI had been selling under Olympia's "suggested" prices (Exhibit 4, Hannah deposition, page 182), there was no problem in working out the fair trade prices. Mr. Hannah immediately telephoned two distributors who readily agreed to sign the fair trade contracts (Exhibit 4, Hannah deposition, pages 64-68), and the execution of them was rushed through to completion on August 8th (R. 79, 81). Adolph Markstein, one of the distributors who signed, told Mr. Hannah that he thought BDI would not even be able to retain its Olympia business with Safeway at the fair trade prices (Exhibit 4, Hannah deposition, page 69).

Olympia and its distributors immediately cooperated to institute a close surveillance over BDI and its customers in order to determine the effect of the program: Before the fair trade prices took effect, Olympia distributor Adolph Markstein reported to Mr. Hannah and to Niels Nielsen, Olympia's Bay Area manager, that BDI had sold 500 cases of Olympia beer to Louis Stores (Exhibit 11). Markstein promised to report "any additional sales or other accounts they may sell" (*ibid.*). Commenting on BDI's sale to Louis Stores, Markstein said pointedly to Hannah: "We

are losing a good customer" (Exhibit 4, Hannah deposition, page 71). Hannah replied that Olympia was in litigation with BDI and said: "I can't discuss this too much, you know that Adolph" (*ibid.*). Home Ice and Cold Storage Co. obtained and mailed to Olympia a copy of a Von's-Shopping Bag memorandum showing that this retailer had received Olympia beer at its central warehouse (*i.e.*, that it had been purchased from BDI) (Exhibit 10). Mr. Markstein reported to Phil Hannah that BDI had made some sales to Purity Stores (Exhibit 4, Hannah deposition, page 69). Olympia's Nielsen surreptitiously checked BDI's Berkeley warehouse, discovered that "they were completely out of Olympia," then checked Safeway's warehouse and reported that Safeway had purchased 24,000 cases from BDI (Exhibit 12). The new fair trade prices had taken effect ten days after Olympia's notice (to permit reposting of new prices as required by California law)[3] (Exhibit 4, Hannah deposition, page 92). By September 9, 1967, Mr. Nielsen "was informed that some of the Louis stores are again buying from our distributor" (Exhibit 12). In other words, the fair trade program had succeeded in preventing BDI from continuing to sell Olympia beer to Louis stores since Louis could now obtain store-door delivery for no higher a price than BDI was compelled to charge for its central warehouse delivery method. Olympia's salesmen had been instructed to embark upon a crash program to call upon every chain store in California in an eight-day period (Exhibit 4, Hannah deposition, page 118). Olympia's district managers were instructed to call upon Safeway's purchasing officers in Los Angeles and Oakland to attempt to persuade this customer of BDI to switch from BDI's central warehouse method to the conventional distributor's store-door delivery method (Exhibit 4, Hannah deposition, pages 114-117). Mr. Hannah had carefully outlined the presentation to be made to Safeway in support of the store-door delivery distributors (*id.* at 116):

> "Q. What were they to say concerning the store-door delivery?

---

3. In fact, BDI was the only distributor who needed to post again, since BDI was the only distributor required to change its prices (Exhibit 4, Hannah deposition, page 182).

A. They were to point out the advantages and also point out the problems that they had run into in the stores, store outages, rotation problems, and other things. We had had during this immediate period of time the authorization for a major promotion. There was inadequate supply of beer to actually put on a promotion during this period of time.

Q. What period is that?

A. Our period of display, Northern California, started on September 5th, and I believe it was to run through the weekend of September 16th."

Counsel for Olympia deny that the establishment of the fair trade program involved any "conspiracy" (Olympia brief, page 5). Yet the evidence demonstrates the very type of combination and conspiracy between a manufacturer and its distributors against an unconventional distributor such as that condemned in *United States v. General Motors Corp.*, 384 U.S. 127, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966). In that case a unanimous Supreme Court found a "classic conspiracy" (384 U.S. at 140):

". . . We have here a classic conspiracy in restraint of trade: joint, collaborative action by dealers, the appellee associations, and General Motors to eliminate a class of competitors by terminating business dealings between them and a minority of Chevrolet dealers and to deprive franchised dealers of their freedom to deal through discounters if they so choose. . . ."

The Court went on to point out that lack of an explicit agreement was not enough to rule out a finding of conspiracy (384 U.S. at 142-143):

". . . it has long been settled that explicit agreement is not a necessary part of a Sherman Act conspiracy—certainly not where, as here, joint and collaborative action was pervasive in the initiation, execution, and fulfillment of the plan. [Citations omitted.]

"Neither individual dealers nor the associations acted independently or separately. The dealers collaborated, through the associations and otherwise, among themselves and with General Motors, and to enforce dealers' promises to forsake the discounters. The associations explicitly entered into a

> joint venture to assist General Motors in policing the dealers' promises, and their joint proffer of aid was accepted and utilized by General Motors."

As in our case, the Court found "multilateral surveillance and enforcement" (384 U.S. at 144-145):

> "What resulted was a fabric interwoven by many strands of joint action to eliminate the discounters from participation in the market, to inhibit the free choice of franchised dealers to select their own methods of trade and to provide multilateral surveillance and enforcement. This process for achieving and enforcing the desired objective can by no stretch of the imagination be described as 'unilateral' or merely 'parallel.' . . ."

In our case, Olympia and its distributors acted to remove from the market BDI which stood alone in its class of warehouse distribution traders offering a price reflecting the economy of that method of distribution (Exhibit 4, Hannah deposition, page 182).

Quite recently, in *Albrecht v. Herald Co.,* 1968 TRADE CASES, para. 72,373, the Supreme Court reversed denial of plaintiff's motion for judgment notwithstanding the verdict to hold that conduct of a newspaper publisher and its distributor against another distributor, deemed "unilateral" by the Court of Appeals, as a matter of law violated the Sherman Act's prohibition against "combinations" (1968 TRADE CASES para. 72,373 at 85,073):

> "On the undisputed facts recited by the Court of Appeals respondent's conduct cannot be deemed wholly unilateral and beyond the reach of § 1 of the Sherman Act. That section covers combinations in addition to contracts and conspiracies, express or implied."

The Court then found that The Herald Co. had participated in an illegal combination on the basis of conduct very similar to that directed by Olympia and its distributors against BDI (*ibid.*):

> ". . . there can be no doubt that a combination arose between respondent, Milne, and Kroner to force petitioner to conform to the advertised retail prices. When respondent learned that petitioner was overcharging, it hired Milne to solicit customers away from petitioner in order to get petitioner to reduce his price. It was through the efforts of Milne, as well as because of respondent's letter

> to petitioner's customers, that about 300 customers were obtained for Kroner. * * * Given the uncontradicted facts recited by the Court of Appeals, there was a combination within the meaning of § 1 between respondent, Milne, and Kroner, and the Court of Appeals erred in holding to the contrary."

In our case, the conduct of the Olympia-distributor combination was much more coordinated and concerted than that found illegal in *Albrecht*. As in *Albrecht*, Olympia and the distributors solicited BDI's customers, and achieved the result of persuading them to stop dealing with BDI (*supra* at p. 10, *infra* at p. 19). In our case, both the fair trading directed against BDI and the eventual termination were the culmination of a long campaign by distributors (*supra* at p. 7). The fair trading was achieved, necessarily, by contractual agreement (*supra* at p. 9). When Olympia refused to deal with BDI, the distributors unanimously followed suit, after discussing it with Olympia (Exhibit 14; Exhibit 4, Hannah deposition, pages 103, *et seq.*).

Olympia's subsequent termination of BDI was admittedly done because the fair trade program had not been entirely effective in preventing BDI from making sales (Exhibit 6, Morgan deposition, pages 10-11):

> "A. Well, Mr. Hannah walked into my office and said, 'Well, we have some orders from BDI.'
>
> * * * * * * *
>
> Q. And what did you say?
>
> A. I said, 'Well it looks like we will have to make a decision.'
>
> Q. And what did he say?
>
> A. This was late in the afternoon, and he said, 'We will probably set up a meeting with Mr. Schmidt.'
>
> * * * * * * *
>
> Q. What was the decision you had reference to?
>
> A. Ship or not to ship."

Mr. Hannah's testimony, too, reveals that it was the receipt of BDI's orders that made it necessary to take the further step of terminating BDI (Exhibit 4, Hannah deposition, page 127):

"Q. Before the meeting, did you tell Mr. Schmidt or Mr. Morgan that you had received these orders?

A. Yes, sir.

Q. And what did you say in that regard?

A. I said, 'We ought to have a meeting on it,' or Bobby, one of us said, I think, that we ought to have a meeting now that we have the order."

The testimony of Olympia's president is to the same effect and further reveals Olympia's concern that BDI had been able to make sales to new customers (Exhibit 5, Schmidt deposition, pages 66-67):

"A. Well, the orders came in, it was necessary for us once again to, you might say, have a meeting and decide what we were going to do.

* * * * * * *

Q. Did you discuss whether it [beer ordered by BDI] was to go to some customer other than Safeway or not?

A. I think we might have. Yes, we did."

Mr. Hannah testified that the problem of continuing to accept BDI's orders during litigation didn't cross his mind (Exhibit 4, Hannah deposition, page 134).

In the face of this evidence, counsel for Olympia claim that the "sole basis" on which Olympia decided to terminate BDI was that BDI had brought this suit (Olympia brief, page 7). The suit was filed August 30, 1967 (R. 1). Mr. Hannah learned about it on September 1st (Exhibit 4, Hannah deposition, page 122). While all three of the Olympia officers mentioned the suit as a ground for termination, the timing of their meeting of September 7th, at which the termination was decided, immediately on receipt of the new BDI orders, demonstrates that the reason for BDI's termination was the threatened sale by BDI to customers in territories assigned other wholesalers.

Apart from that proof of Olympia's primary and immediate purpose in terminating BDI, it is no defense for Olympia to claim that it terminated BDI because BDI had filed suit against Olympia for violation of the antitrust laws. Until the recent decision of the Supreme Court in *Albrecht v. Herald Co.*, 1968 TRADE CASES

para. 72,373, there had been a split among the circuits on the question whether a *unilateral* termination (unlike Olympia's termination of BDI resulting from a combination) of a distributor for asserting rights under the antitrust laws was actionable.

The Court of Appeals for the Eighth Circuit had held in *Albrecht v. Herald Company*, 367 F.2d 517, 523 (8th Cir. 1966), that the defendant newspaper publisher had a legal right to terminate the plaintiff for filing an antitrust suit against it. The Court had cited, as authority for the proposition, the case relied upon by Olympia, *House of Materials, Inc. v. Simplicity Pattern Co.*, 298 F.2d 867 (2d Cir. 1962) (Olympia brief, page 23). In *Albrecht*, the Supreme Court reversed as a matter of law, holding that it was error for the Court of Appeals to affirm the judgment of the District Court which had denied plaintiff's motion for judgment notwithstanding a verdict for defendant (1968 TRADE CASES, page 85,075). The Supreme Court noted in its opinion, without further comment (*id.* at 85,073), that the plaintiff had been terminated "in response" to the filing of the antitrust suit.

Thus, the Supreme Court holding endorsed the doctrine of the other line of cases that termination of a distributor for filing suit under the antitrust laws cannot be justified whether or not it is unilateral. This line of cases is exemplified by Judge Sweigert's opinion in *F. K. Weingartner v. Union Oil Co. of California*, 1966 TRADE CASES para. 71,757 (N.D. Cal 1965), granting a preliminary injunction against a refusal to deal despite defendant's claim that it could not be enjoined from terminating relations with a plaintiff who had sued it. In that case Judge Sweigert rejected the conflicting ruling in *House of Materials, Inc. v. Simplicity Pattern Co.*, 298 F.2d 867 (2d Cir. 1962) (Olympia brief, page 23), and followed that of the Third Circuit in *Bergen Drug Company v. Parke, Davis & Company*, 307 F.2d 725 (3rd Cir. 1962). (1966 TRADE CASES, page 82,501).

In *Bergen Drug Company v. Parke, Davis & Company,* 307 F.2d 725 (3d Cir. 1962), the Court reversed and remanded *with directions to grant a preliminary injunction* enjoining defendant from refusing to deal with plaintiff although the undisputed

reason for the termination had been the filing of suit under the antitrust laws. The Court stated (page 727):

> ". . . The undisputed facts here are that the buyer-seller relationship was discontinued because of the filing of the main action. True enough, the defendant can choose customers, but it should not be permitted to do so in order to stifle the main action, especially where it is apparent that such conduct will further the monopoly which plaintiff alleges defendant is attempting to bring about and which, if proved, would entitle plaintiff to permanent relief. . . ."

Olympia would avoid a meaningful decision from this Court by urging (1) that the facts were disputed (Olympia brief, pages 2-7), and (2) that the District Court ignored the facts and acted under some equitable power to maintain the status quo "extrinsic of antitrust considerations" (*id.* at 11). To the contrary, the error was one of law (BDI opening brief, page 15); the District Court explained that it would not prohibit Olympia from using California's fair trade law (R.T. October 3, 1967, pages 10, 41-42). It would have been clearly erroneous for the District Court to have made any finding other than that Olympia's actions in fair trading and subsequently terminating BDI were taken to enforce Olympia's illegal territorial and customer restrictions (*supra* at p. 6). Since findings have been waived by the parties (R.T. October 3, 1967, page 65), and since the Court's conclusions were based upon an erroneous "application of a legal standard" to documentary evidence, this Court "need give no weight to a trial court's conclusions of law," *Lundgren v. Freeman,* 307 F.2d 104, 115 (9th Cir. 1962); *Fleischmann Distilling Corp. v. Maier Brewing Company,* 314 F.2d 149, 152 (9th Cir. 1963).

2. The state law does not prevent this Court from enjoining the use of fair trade contracts to enforce a system illegal under the Sherman Act.

Claiming that "BDI's appeal is a disguised attack on California's fair trade laws" (Olympia brief, page 12), Olympia devotes an entire section of its brief to an argument of the legality under California law of fair trading at the wholesale level without ref-

erence to its use to accomplish an illegal object.[4] Completely overlooked is the very issue we have raised: that acts wholly innocent in themselves are illegal when they constitute "means used to accomplish the unlawful objective." Olympia has chosen not to argue *American Tobacco Co. v. United States*, 328 U.S. 781, 66 S.Ct. 1125, 90 L.Ed. 1575 (1946) (BDI opening brief, page 14), and the other cases we cited to the same effect (BDI opening brief, pages 14-18) as beside the point and unworthy of an extension of Olympia's brief (Olympia brief, page 16). To explain its failure to meet this vital legal issue in the case, Olympia effortlessly assumes the point—it assumes that it has not violated the antitrust law (Olympia brief, page 16):

> ". . . Whatever may be the rule when one uses a statutory exemption to violate the antitrust laws, that rule will not apply if one does not violate the law. . . ."

We submit, then, that, although by default, Olympia has admitted the point of law which was a basis for denial of the injunction against Olympia's fair trade program in the court below (BDI opening brief, page 15). The cases in our opening brief which Olympia refused to extend its brief to answer, establish that if "one uses a statutory exemption [including fair trade] to violate the antitrust laws," such otherwise lawful means should be enjoined (BDI opening brief, pages 14-18).

3. Olympia's assertion—without demonstration or argument—that BDI has made no case for injunctive relief is no justification for delay of relief to BDI.

Olympia argues first (Olympia brief, page 18) that the injunction should not be directed because the case does not warrant "extraordinary treatment." Apparently this point is intended to be proven by two subpropositions stated at page 19: that "BDI did not carry its burden of proof"; and that "the lower court was properly reluctant to resolve the ultimate factual issues on which this case turns."

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4. We do not concede its legality under state law, but on this appeal have emphasized misuse of the fair trade laws by Olympia.

Olympia's claim that we haven't proven our case is answered in detail above (*supra* at pp. 3-14). Olympia has made no factual analysis showing that the cases cited (Olympia brief, page 19) have any particular significance to the facts of our case. Our proof speaks for itself.

Olympia's second proposition in support of its argument that we have made no case is that the decree sought by BDI would alter the status quo (Olympia brief, page 18). In support of this proposition, Olympia quotes *Hershel California Fruit Products Co. v. Hunt Foods,* 111 F.Supp. 732 (N.D. Cal. 1953), to the effect that "preservation of the status quo should not be confused with the economic stabilization of a whole industry" (Olympia brief, page 20).[5] That admonition is inapplicable to our case in which *only BDI's* prices were affected by Olympia's fair trade program, since no other distributor but BDI had been selling below the minimum prices so established (Exhibit 4, Hannah deposition, page 182). Nevertheless, the *Hershel California* opinion is helpful since it spells out the accepted definition of "status quo" (111 F.Supp. at 734):

> ". . . The term 'status quo' ordinarily refers to the last actual peaceable, noncontested status of the parties to the controversy which preceded the pending suit and which should be preserved until a final decree can be entered."

Since Olympia does not contest the legality of BDI's notice that it intended to commence selling to new customers (R. 74, 76), nor its sales to them, there seems no other conclusion than that "the last actual peaceable, noncontested status of the parties to the controversy which preceded the pending suit" was the status immediately prior to the effective date of the fair trade program of which BDI complains.

In support of its final proposition against injunctive relief, that BDI would not suffer irreparable harm if the decree were denied (Olympia brief, page 18), Olympia has made no effort to dis-

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5. This is also the third point urged by Olympia (Olympia brief, page 18).

cuss the evidence. BDI's factual evidence of irreparable injury thus stands unchallenged: Until the fair trade program, Olympia products constituted over 25% of BDI's business (R. 66). BDI's unique appeal to customers is based upon its ability to distribute multiple brands at the retailer's warehouse, and it is likely that BDI will lose some of its customers entirely if it is prohibited for very long from supplying Olympia beer at warehouse distribution prices on the same basis as its few other popular beers (R. 118). BDI relies upon bank financing which may be difficult or impossible to secure with Olympia sales dwindling or eliminated (R. 119-120). The damages resulting from such a drastic cutback in BDI's operations (whether from total loss of Olympia sales or partial loss due to retailers' lack of interest in warehouse deliveries at high store-delivery prices) are difficult if not impossible to calculate (R. 250, et seq.). These calculations would be much more difficult as to BDI's new Olympia customers as to whom the base period of sales was much shorter (R. 253-254). BDI has already lost the Olympia business it had commenced to develop with Louis Stores and Purity Stores (Exhibits 12, 13).

We submit that Olympia's unsupported assertions that BDI has not proved irreparable damage are as untenable as the other Olympia assertions discussed above.

4. There is no merit to Olympia's appeal from the limited injunction which the Court did grant.

Olympia's argument that it was deprived of a right to exercise a free choice of customers (Olympia Brief at 23) misstates the law: contract or not, Olympia was not entitled to terminate relations with a customer in furtherance of conduct which violates the antitrust laws (*supra* at pp. 11-16). Fatal to Olympia's appeal, and a vital consideration on BDI's appeal, is Olympia's assumption (which it contends is not a concession) "that it will not suffer irreparable damage by continuance of the preliminary injunction until trial" (Olympia brief, page 22).

CONCLUSION

We think we have demonstrated that there is no bona fide dispute as to the basic facts. Nor can defendant eliminate the governing law by refusing to argue it. A definitive decision of this Court on the merits of the simple issues presented will give prompt and effective justice, whether for plaintiff or defendant. A practical step will have been taken to reduce the congestion, confusion and futility of needless delay in adjudication. We ask that this Court enjoin the application of Olympia's fair trade program to BDI, eliminate the volume limitation conditioning the injunction against refusal to deal, and affirm the remainder of the order.

Dated: March 28, 1968.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

B. H. PARKINSON, JR.
Attorney

(Appendices Follow)

Appendix 1

Admissions of Counsel for Olympia as to Purpose of Fair Trading:

"Mr. Parkinson: Let me put it the way we see it, if Your Honor please. I think it is clear, and they have admitted, that they fair-traded because of BDI's announcement that they were going to sell to others. It's just——

"The Court: Well, do you concede that?

"Mr. Parkinson: It can't be denied.

"The Court: Seems to me that you do.

"Mr. Toy: Stated that way, I think I might quibble with the words a little bit, Your Honor, but in substance that is a fair statement.

"The Court: I want to give you an escape hatch.

"Mr. Toy: I don't think there is a big dispute about it, though.

"The Court: So defendant admits your point. Want a page number on that?

"Mr. Parkinson: Yes, please, Your Honor.

"The Court: Okay.

"Mr. Parkinson: Secondly, I think it's also undeniable that the purpose of the fair-trading was to prevent, if possible, BDI from making these sales to other customers and in other territories. And I ask counsel if he will concede that as well.

"Mr. Toy: Certainly will not.

"The Court: Why not?

"(To the Reporter.) Read the question by Mr. Parkinson again.

"Now don't let me lead you into error. I am just asking you.

"(Record read.)

"Mr. Toy: Well, Your Honor, if Mr. Parkinson is attempting to get me to concede that we were telling BDI they couldn't sell to somebody else, I will deny it.

"The Court: No, he is not saying that. That question doesn't say what you say. That question goes to purpose. Wasn't it the purpose of your client to prevent the plaintiff, to do what it could

to prevent the plaintiff from making sales to others than Safeway; and indeed, as a matter of fact, by this time probably to Safeway.

"Mr. Toy: I will concede that one of the primary purposes of Olympia in fair-trading was to discourage an extension of the central warehouse form of distribution, which I understand from Mr. Girard's testimony is the only method of distribution of Olympia beer which BDI contemplated.

"The Court: All right. Then it seems to me your answer, to put it in somewhat different words, is that a primary or major consideration for fair-trading was to prevent BDI from selling at less than a wholesale fair-trade price to any central warehouse retailer, with the view that one of the effects of fair trading would be to make it difficult if not impossible for sales to be made by BDI.

"Mr. Toy: All right, Your Honor. But I think that's a far cry from saying that we intended to prevent them selling other customers or in other territories." (R.T. 93-95)

Appendix 2

Testimony of Olympia President Robert Schmidt Concerning Olympia's Consideration of Effect Upon Other Distributors of Sale by BDI to New Customers:

"Q. Did you discuss the effect that any one of these alternatives might have upon your distributor organization?

A. I don't think that it was necessary to discuss it. Any good sound businesman in this situation just knows.

Q. You had been told over the years what the attitude of the distributor was as to BDI, of course?

A. Certainly.

Q. And did you discuss this attitude in this conversation with Mr. Hannah?

A. I don't think so, not at this time.

Q. I take it it wasn't necessary?

A. No, I didn't.

Q. Did you discuss the request that the distributors had been making over the years?

A. Not at this point.

Q. And did you discuss any action that your distributors might take if you continued to deal with BDI?

A. I can't specifically recall, but I think—Well, I know that I knew what this would mean, what it could mean.

Q. In what respect? What do you mean by that?

A. Once again, that we would not have an orderly distribution of our product. We would have a good chance that our product would just fall into limbo because it would not have proper merchandising, proper sale, proper distribution, particularly in the smaller accounts, particularly into the, let's say, on-sale premises, things like this.

Q. Did you discuss possible retaliation by any of your other distributors?

A. No.

Q. Did you have that in mind?

"Mr. Toy: What do you mean by retaliation, counsel?

"Mr. Parkinson: Any action he might take. The witness started to answer.

A. I don't think so, no.

Q. You didn't discuss that?

A. No. I know we didn't discuss it at that point.

Q. In your opinion, would your distributors have been unhappy if you had continued to deal with BDI on the previous basis after they commenced selling to others than Safeway?

A. You say would they be unhappy?

Q. Yes.

A. If BDI was allowed to sell to other people than Safeway?

Q. Yes.

A. I think that is quite obvious, yes.

Q. They would be unhappy?

A. I think that they would be.

Q. Do you think that you would have received any complaints from them?

A. If they were losing business and losing markets?

Q. Yes.

A. Yes, I think we would."

(Exhibit 5, Schmidt deposition, pages 58-60)